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LIMITED, CONDITIONAL, AND SUSPENDED DISCHARGES IN ANGLO-AMERICAN BANKRUPTCY PROCEEDINGS

DOUGLASS G. BOSHKOFF†

"On the whole, Gentlemen, I think I may safely say, that this Statute would have been more acceptable had it breathed somewhat less strongly the spirit of commerce, and somewhat less feebly the spirit of justice and humanity."¹ So spoke John MacQueen in 1851 during a lecture at Lincoln's Inn. His topic was the 1849 English bankruptcy statute.² The object of his criticism was the debtor discharge provision found in the new legislation.³ Today, the passage of more than 130 years has not diminished the debate concerning the propriety and the form of discharge policy in bankruptcy legislation.⁴

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¹ J.F. MacQueen, *A Lecture on the Early History and Academic Discipline of the Inns of Court and Chancery Delivered Before the Benchers at Lincoln's Inn* 23 (Nov. 20, 1851) (copy on file with the University of Pennsylvania Law Review) [hereinafter cited as *MacQueen Lecture*].

² An Act to amend and consolidate the Laws relating to Bankrupts, 12 & 13 Vict., ch. 106 (1849).

³ *Id.* §§ 198-207, 256; *MacQueen Lecture*, *supra* note 1, at 17-23.

⁴ A good example of the controversy that can be generated by discharge legislation is found in the history of what is now 11 U.S.C. § 523(a)(8) (Supp. V 1981). This provision, which controls the dischargeability of certain educational loans, first appeared in a somewhat different form as § 439A(a) of the Educational Amendments of 1976, Pub. L. No. 94-492, 90 Stat. 2081, 2141. The House Judiciary Committee did not recommend that the section be included in the bankruptcy bill that was sent to the House floor; however, a floor amendment added it back into the bill. H.R. REP. NO. 995, 95th Cong., 1st Sess. 132, 536-38, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5963, 6423-25. Thirty pages of the House report are devoted to this one subject. *Id.* at 131-62, 1978 U.S. CODE CONG. & AD. NEWS at 6093-123. This was a remarkably detailed analysis in view of the other important bankruptcy issues before the House at that time. *See also* S. REP. NO. 989, 95th Cong., 2d Sess. 79, *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 5785, 5865 (Senate comments on the provision); 124 CONG. REC. 32,399 (1978), *reprinted in* 1978 U.S. CODE CONG. & AD. NEWS 6436, 6454 (remarks of House leaders).

One measure of an issue's controversial nature is the extent to which it receives press and television coverage. Bankruptcy has not been a topic of great public interest—until recently. For instance, a recent MacNeil-Lehrer TV broadcast was devoted entirely to personal bankruptcy discharge policy. Transcript, *The MacNeil-Lehrer Report* (PBS television broadcast, Oct. 8, 1981). *See also* a recent four-part series on bankruptcy in the *New York Times*. N.Y. Times, Sept. 30, 1982, at A1, col. 1; Oct. 1, 1982, at A1, col. 2; Oct. 2, 1982, at A1, col. 3; Oct. 4, 1982,

Discharging the debtor from monetary obligations to her creditors is one possible result of a bankruptcy proceeding.⁵ The bankruptcy discharge is a central feature of Anglo-American bankruptcy law; however, it is absent from continental legal systems such as those of France, Germany, Italy, and the Netherlands.⁶ The first bankruptcy discharge was authorized by a statute enacted in 1705 during the reign of Queen Anne.⁷ Since then there have been several significant shifts in English discharge policy. Changes can also be seen in American discharge policy as it evolved during the nineteenth century. That period witnessed the enactment of four separate bankruptcy statutes, and each one contained different discharge features.⁸ The legislative changes in both countries resulted from shifts in the balance of legislative power from creditor to debtor interests and shifts in society's perception of the public interest in debtor rehabilitation.

Factors which may influence a legislature when it adopts a particular discharge rule include the perceived desirability of having each bankrupt's eligibility for discharge dependent on the particular facts of

at A1, col. 4.

⁵ But it is not an inevitable result. Not all debtors receive a discharge and not all debts are discharged. Early English bankruptcy laws, for example, did not provide for any discharge. *See, e.g.,* An act against such persons as do make bankrupts, 34 & 35 Hen. 8, ch. 4 (1542).

If the law simply wipes out the claims altogether, we may be dealing with an economic measure of the highest importance, but it is not bankruptcy. Such laws, let us remember, are not unexampled in history. At various times in ancient society there was a demand that all debts be cancelled as of a certain date. The Biblical Jubilee and the Athenian *seisachtheia* seem to have been measures of this sort. The Roman *tabulae novae* undoubtedly constituted one. . . .

It may be well to remember that an effective cancellation can be obtained not only by the formal Roman expedient of *tabulae novae*, but by a deliberate and immense inflation. This was the case in Germany before 1923, when the circulating medium was reduced in value below the paper it was printed on and was nonetheless legal tender for pre-existing debts. Whatever this method is called, it can scarcely be called one of bankruptcy.

Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 6 (1940) (footnotes omitted).

⁶ 1 J.H. DALHUISEN, DALHUISEN ON INTERNATIONAL INSOLVENCY AND BANKRUPTCY § 1.07[1] (1979) [hereinafter cited as DALHUISEN]; J.A. MACLACHLAN, HANDBOOK OF THE LAW OF BANKRUPTCY § 123 (1956). It should be noted that some civil law countries do have a discharge system as part of their bankruptcy law, but discharge is always conditional on the approval of some majority of the bankrupt's creditors. *See also* J.H. DALHUISEN, COMPOSITIONS IN BANKRUPTCY 2 (1968).

⁷ An Act to prevent Frauds frequently committed by Bankrupts, 4 & 5 Anne, ch. 17, § 8 (1705). Not all debtors were eligible for bankruptcy, but for those who were, the Act provided complete relief. *See id.* §§ 6, 8, 18 (classes of debtors eligible for discharge); *id.* §§ 7, 13, 16, 19 (classes of debtors ineligible for discharge). It discharged all debts existing when the proceeding was commenced and was available even if creditors objected. *Id.* §§ 8, 20. This generous provision lasted one year. In 1706 Parliament imposed a requirement that four-fifths of the creditors in number and amount consent to the granting of the discharge. An Act to explain and amend an Act of the last Session of Parliament for preventing Frauds frequently committed by Bankrupts, 6 Anne, ch. 22, § 2 (1706).

⁸ Three of the statutes had short lives, *see infra* note 145, and it was not until 1898 that bankruptcy legislation became a permanent part of federal law. *See generally* C. WARREN, BANKRUPTCY IN UNITED STATES HISTORY (1935).

her case, the value society places on the activities of the credit extender, and the degree to which a fresh-start policy is seen as desirable. When the court enjoys discretionary authority to order discharge, these same factors, along with the debtor's actual situation (for example, her character, ability to make further payments, circumstances under which she incurred the obligations, and willingness to cooperate with the bankruptcy administration), may influence the manner in which the statute is applied. To some extent, the considerations that shape discharge policy cannot be reconciled and difficult choices must be made. In the United States, we have chosen to make many of these difficult choices by legislative rule rather than rely on the exercise of judicial discretion. As a result, the discharge process in the United States can be, as we shall see, rather inflexible. Theoretically, it is open to exploitation. Although there are few documented cases of abuse, creditors remain convinced that the bankruptcy courts are crowded with debtors who really could honor their obligations if only they made an honest effort.⁹

The English system is not subject to the same criticism. Its judges have the power, through application of rules of condition and suspension, to respond to creditor demands for further payment. It is this feature which commends it to American creditors.

From time to time it has been asserted that we should make greater use of rules of condition and suspension. Although rejected in the past, the argument continues to be made.¹⁰ Accordingly, the English

* Documentation of abuse of the bankruptcy process tends to be rather anecdotal. See, e.g., H.R. REP. NO. 595, *supra* note 4, at 158-59, 1978 U.S. CODE CONG. & AD. NEWS at 6119-20 (letter of Ronald J. Iverson, exec. dir. of Vt. Student Assist. Corp.) But see *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civil and Constitutional Rights of the House Comm. of the Judiciary*, 94th Cong., 1st Sess. 1072-75, 1087-89, 1120-21, 1122-27 (1976) (statistical information on increase in student loan recipients' defaults and bankruptcies) [hereinafter cited as *Bankruptcy Act Revision*]; see also R. DOLPHIN, AN ANALYSIS OF ECONOMIC & PERSONAL FACTORS LEADING TO CONSUMER BANKRUPTCY 110-11 (1965) (statistical study of personal bankruptcy in one Michigan county during 1963). The transgressions of an Arkansas couple often were cited during hearings on the appropriate treatment of student loans. *Bankruptcy Act Revision*, *supra*, at 1066, 1068, 1101-03, 1121-22. See generally CREDIT RESEARCH CENTER, MONOGRAPH NO. 23, CONSUMER BANKRUPTCY STUDY (VOL. 1): CONSUMER'S RIGHT TO BANKRUPTCY, ORIGINS AND EFFECTS 72 (1982) (recent study by the Credit Research Center of Purdue University's Krannert Graduate School of Management) [hereinafter cited as *Purdue Study*].

Depending upon all the assumptions made, 15 percent to 30 percent of bankrupt debtors probably could repay all of their nonmortgage debts out of their future income, while as many as 37.4 percent of bankrupt debtors probably could repay at least half their debts out of future income. . . . Because consumers typically borrow against future income rather than assets, only five percent of the respondents could repay their debts by liquidating assets, and half of those would not have been able to repay their debts from future income.

But see N.Y. Times, Oct. 13, 1982, at A30, col. 5 (letter-to-the-editor written by author of this Article criticizing the *Purdue Study*, *supra*).

¹⁰ Professor MacLachlan suggested importation of the English system of conditional and suspended discharges because he thought it would introduce a helpful degree of flexibility into bank-

attitude toward relief from debt is of general interest to the American legal community: those who understand what actually takes place in English bankruptcy courts will also understand the potential impact of current proposals for changes in our own discharge policy.¹¹

The purpose of this Article is to contrast British and American discharge policy. Part I of this Article briefly defines three types of debtor discharge rules: rules of condition, rules of suspension, and rules of limitation. Parts II and III demonstrate how the English bankruptcy courts actually deal with the debtors that come before them. Part IV offers an explanation of how two common law jurisdictions with similar legal traditions came to choose radically different techniques for reconciling debtor and creditor interests. Finally, Part V discusses current proposals for revision of the American bankruptcy statutes and suggests that adoption of rules of condition and suspension would require a radical rethinking of the roles American society expects bankruptcy judges to perform.

I. DEFINING LIMITED, CONDITIONAL, AND SUSPENDED DISCHARGES

The terms "limitation," "condition," and "suspension" refer to discrete techniques for reconciling the interests of the debtor, the creditor, and the public in a bankruptcy proceeding. A limited discharge is one that is available only to certain classes of debtors,¹² that may be

ruptcy discharge practice. He did not, however, support the use of bankruptcy proceedings as an additional collection device. J.A. MACLACHLAN, *supra* note 6, § 122. *But cf. id.* § 100 ("the prospect of a discharge serves . . . to induce compliance with the Bankruptcy Act as a branch of collection law"). The most forceful brief for importation of the English practice is found in ATTORNEY GENERAL MITCHELL, STRENGTHENING OF PROCEDURE IN THE JUDICIAL SYSTEM, S. EXEC. DOC. NO. 65, 72d Cong., 1st Sess. xii, 17-19, 57-58, 99-103 (1932). It has been suggested that a debtor's eligibility for discharge should include a consideration of the value of human capital. See Discussion, *The Economics of Bankruptcy Reform*, LAW & CONTEMP. PROBS., Autumn 1977, at 123, 156-58, 161. For a discussion of proposals to force the use of old Chapter XIII, see *Wage Earner Plans Under the Bankruptcy Act: Hearings on H.R. 1057 and H.R. 5771 Before Subcomm. No. 4 of the House Comm. on the Judiciary*, 90th Cong., 1st Sess. (1967); Comment, *Should Chapter XIII Bankruptcy Be Involuntary?*, 44 TEX. L. REV. 533 (1966); Countryman, *Proposed New Amendments for Chapter XIII*, 22 BUS. LAW. 1151 (1967); Driver, *Proposal—To Amend the Bankruptcy Act to Require that Consideration be Given to the Use of Chapt. XIII*, 18 PERS. FIN. L.Q. REP. 41 (1964). The Bankruptcy Commission rejected a proposal for involuntary Chapter XIII proceedings primarily on pragmatic grounds. See *Report of the Commission on the Bankruptcy Laws of the United States*, H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. I, at 83, 158-59 (1973) [hereinafter cited as BANKRUPTCY REPORT].

The treatment of student loans in the new Bankruptcy Code, 11 U.S.C. § 523(a)(8) (Supp. V 1981), suggests a limited acceptance of the concept of conditional discharge in the United States. The debtor's future earning power may also be considered when determining whether a (new) Chapter 13 plan can be confirmed. See *id.* § 1325(a)(3),(6); *infra* text accompanying notes 178-79.

¹¹ See *infra* text accompanying notes 166-231.

¹² See, e.g., 11 U.S.C. § 727(a)(8) (Supp. V 1981) (no debtor can receive a second discharge within six years of receiving most recent discharge).

denied to persons within the eligible class,¹³ or that does not discharge certain types of obligations.¹⁴ Limited discharge legislation contemplates only two courses of action: the debtor receives either an immediate discharge or none at all. The court has no discretion; it merely applies inflexible rules. For example, in the United States the debtor is not entitled to a discharge in a liquidation proceeding if she has received a discharge in another liquidation proceeding during the preceeding six years.¹⁵ This is an absolute rule, and the court cannot grant a second discharge within the six-year period even if it is convinced that the debtor really needs and deserves such relief. Conversely, the court is not authorized to deny a discharge when more than six years separate the two proceedings even if it believes that the debtor really does not need rehabilitative relief.

Conditional discharge rules, on the other hand, authorize the court to consider how much the debtor has paid, or will be able to pay, creditors. Such rules may, but need not, permit the exercise of discretion. For instance, the short-lived American Bankruptcy Act of 1867 contained two conditional limitations on the grant of a discharge.¹⁶ A debtor could not obtain a discharge if her estate paid unsecured creditors less than fifty percent of the outstanding debts (condition 1—no discretion) unless a majority of her creditors in number and amount consented to her discharge (condition 2—discretion to be exercised).¹⁷ Rules of condition are pervasive in English bankruptcy law,¹⁸ but generally have not played a role in the American system. However, section 523(a)(8) of the new bankruptcy code declares nondischargeable a debt owed

for an educational loan made, insured, or guaranteed by a governmental unit, or made under any program funded in whole or in part by a governmental unit or a non-profit institution of higher education, unless—

¹³ See, e.g., *id.* § 727(a)(2)-(9) (certain debtor conduct can result in denial of discharge).

¹⁴ See, e.g., *id.* § 523(a)(1), (2) (certain tax claims not affected by bankruptcy discharge); Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 28(1)(a), amended by Insolvency Act, 1976, ch. 60, § 8(a) (same).

¹⁵ 11 U.S.C. § 727(a)(8) (Supp. V 1981).

¹⁶ Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. 517, 533. A more rigorous rule applied to the debtor who had already received a bankruptcy discharge in a prior proceeding. *Id.* § 30, 14 Stat. 517, 532.

¹⁷ Note that in this case the statute authorizes the creditors, not the court, to exercise discretion. As is discussed *infra* text accompanying notes 136-44, however, the legislatures of both countries have since concluded that creditors may abuse this discretion and therefore all present conditional discharge rules place discretion with the court.

¹⁸ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26, amended by Bankruptcy (Amended) Act, 1926, 16 & 17 Geo. 5, ch. 7, § 1, and amended by Criminal Law Act, 1967, ch. 58, § 10(2), sched. 3, Pt. III, and amended by Insolvency Act, 1976, ch. 60, §§ 6, 8(9) [hereinafter cited as Bankruptcy Act of 1914, § 26].

. . . .

(B) excepting such debt from discharge under this paragraph will impose an undue hardship on the debtor and the debtor's dependents.¹⁹

This rule is one of condition—it invites the court to look at the earning power of the debtor and to decide whether some or all of the loan can be repaid out of future earnings.

A final technique is suspension of the discharge for a stated period of time. Suspended discharges are authorized expressly by statute in England and Wales and permit a court to express displeasure with the debtor's conduct by temporarily withholding the full benefits of discharge.²⁰ Courts in the United States, acting under the now-repealed Bankruptcy Act of 1898,²¹ occasionally withheld discharges for a limited period of time to allow a creditor to perfect his claim against the bankrupt.²²

With this basic understanding of limited, conditional, and suspended discharges, it is possible to examine English and American bankruptcy law with the objective of understanding how the respective laws reflect different functions and societal expectations.

¹⁹ 11 U.S.C. § 523(a)(8) (Supp. V 1981).

²⁰ Bankruptcy Act of 1914, § 26, *supra* note 18. Under a system in which the debtor's postpetition earnings remain available to pay creditors, a suspended discharge theoretically could also be used to reach those earnings. In practice, the English bankruptcy courts use conditional discharges and suspended discharges to achieve different objectives. *See infra* text accompanying notes 116-17 & 129-32 (Hearings Numbers Two and Five).

²¹ Ch. 541, 30 Stat. 544 (1898) (repealed 1979).

²² In *Lockwood v. Exchange Bank*, 190 U.S. 294 (1903), the Supreme Court held that the bankruptcy court could withhold the discharge for a reasonable period of time to permit a creditor with a waiver of exemption to obtain a judicial lien on otherwise exempt property. Courts also withheld discharges until joint creditors of a husband and wife could obtain judicial liens on property held as tenants by the entirety. *See, e.g., Phillips v. Krakower*, 46 F.2d 764 (4th Cir. 1931). *See generally* 1A COLLIER ON BANKRUPTCY ¶¶ 14.64, 16.06 (J. Moore 14th ed. 1978) (Postponement of discharge pending the determination of a suit or proceeding in which persons other than the bankrupt are parties is appropriate where a discharge would tend to affect adversely the rights of such persons).

It may be that the practice of suspending a discharge when exempt property is involved will not be continued under the new bankruptcy statute. The *Lockwood* decision, which had authorized suspension, has been overruled; waivers of exemption are no longer enforceable. *See* 11 U.S.C. §§ 522(f), 541(a)(1) (Supp. V 1981); H.R. REP. NO. 595, *supra* note 4, at 126-27, 177-78, 362, 367-68, 1978 U.S. CODE CONG. & AD. NEWS at 6087-88, 6137-38, 6318, 6323-24; S. REP. NO. 989, *supra* note 4, at 82, 1978 U.S. CODE CONG. & AD. NEWS at 5868; *see also In re Lantz*, 7 Bankr. 77, 79-80 (Bankr. S.D. Ohio) (even exempt property passes to trustee). But one court has suggested that the practice will continue for the joint creditor seeking to enforce a claim against an entire estate. *See In re Ford*, 3 Bankr. 559, 576 (Bankr. D. Md. 1980) (dictum), *aff'd*, 638 F.2d 14 (4th Cir. 1981). *But see In re Trickett*, 14 Bankr. 85 (Bankr. W.D. Mich. 1981) (creditors need not obtain a judgment in state court because under 11 U.S.C. § 541(a)(1) the bankruptcy court had jurisdiction over the debtor's interest in property owned by tenancy by the entirety and could dispose of said interest).

II. AN OVERVIEW OF BANKRUPTCY PROCEEDINGS IN ENGLAND AND WALES²³

A. *Institution of Proceedings*

Bankruptcy proceedings in England and Wales may be either voluntary or involuntary from the debtor's perspective.²⁴ A voluntary proceeding is initiated easily by the debtor²⁵ if she is eligible for bankruptcy. If, however, the proceeding is involuntary, commenced upon the petition of one or more creditors, several additional requirements must be satisfied. The petition must demonstrate, among other things, a liquidated debt owed to the petitioner(s) amounting to at least £200 and the commission of an act of bankruptcy.²⁶ The Bankruptcy Act of 1914 lists eight acts of bankruptcy;²⁷ many are similar to the acts of bankruptcy required for a creditor's petition under our recently repealed Bankruptcy Act of 1898.²⁸ One example common to both systems would be the making of a fraudulent conveyance.²⁹

Failure to respond to a bankruptcy notice is a uniquely English justification for a creditor's petition.³⁰ A creditor with a final judgment or order may apply to the court for issuance of a bankruptcy no-

²³ The bankruptcy process described in this Article is not generally operative in Scotland or Northern Ireland. See Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 169(2). Throughout this Article the term "England" refers to both England and Wales.

²⁴ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, §§ 4, 6, *amended by* Insolvency Act, 1976, ch. 60, § 1 (minimum amount required for petition).

²⁵ The bankruptcy statute applies only to natural persons. It contains a definition which could be interpreted as including a corporation within the class of eligible debtors. Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 1(2). Another section of the statute, however, makes it clear that a separate liquidation procedure applies to all corporations and certain partnerships. *Id.* § 126.

²⁶ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59 § 4, *amended by* Insolvency Act, 1976, ch. 60, § 1, sched. 1.

²⁷ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 1(1), *amended by* Insolvency Act, 1976, ch. 60, § 4. Other statutes have created additional acts of bankruptcy. See, e.g., Administration of Justice Act, 1970, ch. 31, § 29(3); Attachment of Earnings Act, 1971, ch. 32, § 4(3). For a general discussion, see M. HUNTER & D. GRAHAM, WILLIAMS AND MUIR HUNTER ON BANKRUPTCY 2 (19th ed. 1979) [hereinafter cited as WILLIAMS & HUNTER].

²⁸ Bankruptcy Act of 1898, ch. 541, § 3, 30 Stat. 544, 546-47 (repealed 1979). The current American bankruptcy statute does not use the term "act of bankruptcy." A more functional basis has been established for determining when creditors may invoke the jurisdiction of the bankruptcy court. See 11 U.S.C. § 303(h) (Supp. V 1981); S. REP. NO. 989, *supra* note 4, at 34, 1978 U.S. CODE CONG. & AD. NEWS at 5820. A recent study sponsored by the English government recommended the abolition of acts of bankruptcy. CORK, INSOLVENCY LAW AND PRACTICE, REPORT OF THE REVIEW COMMITTEE, CMD. 8558, ¶¶ 529-531 (1982) [hereinafter cited as CORK, FINAL REPORT].

²⁹ Compare Bankruptcy Act of 1898, ch. 541, § 3(a)(1), 30 Stat. 544, 546 (repealed 1979) with Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 29, § 1(1)(b).

³⁰ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 29, § 1(1)(g), *amended by* Insolvency Act, 1976, ch. 60, § 4.

tice³¹—a formal demand for payment.³² The debtor then has ten days in which to discharge the obligation.³³ English law also provides for a response by affidavit showing that there is a setoff to the creditor's claim.³⁴ If the allegations and the affidavit are satisfactory, the court will schedule a hearing to determine the merits of the averred setoff.³⁵ A debtor who does not file such an affidavit and who fails to discharge the obligation stated in the bankruptcy notice within ten days commits an act of bankruptcy and is subject to an involuntary petition.³⁶

Under American law, failure to respond to a demand for payment is not an act of bankruptcy. The disparate treatment accorded to such failures reflects the somewhat different ways English and American creditors view the bankruptcy process. In the United States, a creditor looks to the bankruptcy court for assistance when other creditors have gained an undue advantage by using the state-law-authorized collection process. A bankruptcy proceeding substitutes a more even-handed and orderly system of collection and distribution for the individualistic state collection law which Professor MacLachlan once aptly referred to as "grab law."³⁷

In England there is an appreciation of the fact that individual collection law and bankruptcy law are, in a sense, opposites.³⁸ But funda-

³¹ *Id.* Original jurisdiction over bankruptcy proceedings is divided between two courts, the High Court and the county courts. In the case of debtors residing in the London bankruptcy district, the petition will be filed with the High Court. For debtors residing outside London, the appropriate place to file is with the county court. Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, §§ 96, 98. In both courts provision is made for a bankruptcy official, called a registrar, who has a function similar to our bankruptcy judge. The registrar in the county court system, however, does not have as extensive powers as a High Court registrar. In the county courts, some bankruptcy matters must be heard by the county court judge. And in both courts some matters are completely outside the jurisdiction of the registrars. In both the High Court and the county courts, a bankruptcy notice is issued by the registrar. *Id.* §§ 96, 98, amended by Insolvency Act, 1976, ch. 60, § 8(9); Bankruptcy Rules, 1952, STAT. INST. 1952 NO. 2113, R. 4, R. 135(1), R. 136, amended by Bankruptcy (Amend. No. 2) Rules, 1956, STAT. INST. 1956 NO. 1197, R. 1(d), amended by Bankruptcy (Amend.) Rules, 1965, STAT. INST. 1965 NO. 1571, R. 1(d). A brief account of the development of High Court and county court bankruptcy jurisdiction appears in I.F. FLETCHER, LAW OF BANKRUPTCY 7-8 (1978). Throughout this Article the term "bankruptcy court" or "bankruptcy judge" refers to the court that has jurisdiction to make the ruling.

³² For an example of the form of a bankruptcy notice, see WILLIAMS & HUNTER, *supra* note 27, at 653-54.

³³ *See id.*

³⁴ Bankruptcy Rules, 1952, STAT. INST. 1952 NO. 2113, R. 137(b), R. 138, R. 139.

³⁵ *Id.* R. 139(1).

³⁶ *See* WILLIAMS & HUNTER, *supra* note 27, at 653-54.

³⁷ J.A. MACLACHLAN, *supra* note 10, § 5.

³⁸ The creditor who initiates bankruptcy proceedings must share whatever is collected with other creditors. First priority in distribution, however, is given to the payment of certain tax and wage claims. Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 33(1)-(2), amended by Bankruptcy (Amendment) Act, 1926, 16 & 17 Geo. 5, ch. 7, § 2, and amended by Reinstatement in Civil Employment Act, 1944, 7 & 8 Geo. 6, ch. 15, § 18(1), (4), and amended by Companies Act, 1947, 10 & 11 Geo. 6, ch. 47, §§ 9(1)-(2), (4)-(6), 115(1), (6), and amended by National Service Act, 11 & 12 Geo. 6, ch. 64, § 48, and amended by Finance Act, 1952, 15 & 16 Geo. 6, ch. 33, § 30(1),

mentally, bankruptcy still is regarded as a part, albeit a distinctive part, of the collection process. As Ian Fletcher tells us:

[A]lthough [English bankruptcy law] is primarily intended to be employed in cases where the debtor is materially unable to pay his debts out of his liquid resources, it should be noted that there is a possibility of its being resorted to in cases where a debtor, although able to pay, refuses to do so. Thus, the law of bankruptcy also constitutes a further species of "ultimate weapon" with which the creditor may contrive to recover what is owed to him.³⁹

Similarly, a recent government-sponsored study of English insolvency law notes:

[T]he insolvency laws are treated by the trading community as an important instrument in the process of debt recovery; the threat or imminence of insolvency proceedings as a weapon in persuading a defaulting debtor to pay or make proposals for the settlement of a debt cannot be underestimated as it constitutes, in the majority of cases, the sanction of last resort for the enforcement of obligations.⁴⁰

Through use of the bankruptcy notice, a creditor may create the substantive basis for a bankruptcy petition and then threaten to commence bankruptcy proceedings. This practice must often be effective, as there is evidence that creditors make ample use of the power to threaten use of bankruptcy. Each year from 1974 to 1979, bankruptcy notices issued by the High Court and by the county courts have exceeded creditors' involuntary petitions by ratios varying from approximately three-

and amended by Purchase Tax Act, 1963, ch. 9, § 30(1), and amended by Finance Act, 1965, ch. 26, § 45(12), sched. 10, pt. II, para. 15(1), and amended by Land Commission Act, 1967, ch. 1, § 77, sched. 12, para. 12, and amended by Statute Law (Repeals) Act, 1975, ch. 10, § 1(1), sched. pt. I, and amended by Social Security (Consequential Provisions) Act, 1975, ch. 18, §§ 1(3), 5, sched. 2, para. 2, and amended by Social Security Pensions Act, 1975, ch. 60, § 65(1), sched. 4, para. 2, and amended by Employment Protection Act, 1975, ch. 71, §§ 63, 67(2), and amended by Development Land Tax Act, 1976, ch. 24, § 42, and amended by Insolvency Act, 1976, ch. 60, § 1(1), (3), sched. 1, pt. I, pt. II, para. 5, and amended by Employment Protection (Consolidation) Act, 1978, ch. 44, §§ 121, 125, and amended by Bankruptcy Rules, 1952, STAT. INST. 1952 NO. 2113, R. 249. Inland Revenue and H.M. Customs and Excise are frequent users of involuntary bankruptcy. See CORK, FINAL REPORT, *supra* note 28, ¶¶ 529-531, 727; *infra* note 152.

³⁹ I.F. FLETCHER, *supra* note 31, at 3. Currently there is a substantial amount of debate concerning the administration of the English bankruptcy system. The Thatcher Government has indicated a desire to reduce the government's involvement in the administrative process. Supporters and critics of these proposals both acknowledge that consideration must be given to whether this will affect the usefulness of bankruptcy as a debt collection device. SECRETARY OF STATE FOR TRADE, BANKRUPTCY, A CONSULTATIVE DOCUMENT, CMD. 7967, at 9 (1980) [hereinafter cited as TRADE BANKRUPTCY]; CORK, BANKRUPTCY, INTERIM REPORT OF THE INSOLVENCY LAW REVIEW COMMITTEE, CMD. 7968, at 4-5 [hereinafter cited as CORK, INTERIM REPORT]; Fletcher, *Bankruptcy Law Reform: The Interim Report of the Cork Committee, and the Department of Trade Green Paper*, 44 MOD. L. REV. 77, 84-85 (1981).

⁴⁰ CORK, FINAL REPORT, *supra* note 28, ¶ 235.

to-one to five-to-one.⁴¹ At least part of the disparity between the number of notices and the number of involuntary petitions exists because debtors, having received the notice, make arrangements for payment and forestall the institution of bankruptcy proceedings.⁴²

If the petition, whether based upon a bankruptcy notice or any other act of bankruptcy, is properly presented, the court will issue a receiving order.⁴³ This order protects the bankruptcy estate; most creditor collection activity is stayed⁴⁴ and the debtor is divested of control of his property.⁴⁵ Adjudication, however, is not the next step. Prior to an

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	High Court Chancery Division		County Court	
	Bankruptcy Notices	Creditors' Petitions	Bankruptcy Notices	Creditors' Petitions
1974	8,637	2,066	21,731	3,904
1975	9,618	2,560	27,342	4,860
1976	8,401	2,560	23,096	5,234
1977	7,068	2,464	13,123	2,372
1978	6,307	2,479	11,327	2,336
1979	6,230	2,403	10,769	2,120

LORD CHANCELLOR'S DEPT., JUDICIAL STATISTICS: ENGLAND AND WALES, CMDS. 6634, 6875, 7254, 7627, 7977 (1975-1979).

⁴² See P. ROCK, MAKING PEOPLE PAY 148-50 (1973). Prior to 1970 creditors rarely used bankruptcy notices except to "scare" debtors, and "overwhelmingly resort[ed] to executions and judgment summonses alone" to enforce judgments. *Id.* The Administration of Justice Act, 1970, ch. 31, §§ 11-30, scheds. 4-8, amended by Attachment of Earnings Act, 1971, ch. 32, § 29(2), however, severely restricted use of both of these devices. Consequently, creditors appear to have been increasingly resorting to forcing bankruptcy upon debtors as a means of enforcing payment of judgment debts. CORK, INTERIM REPORT, *supra* note 39, at 4-5. This fact makes even more notable the difference between the number of bankruptcy notices and creditor petitions during the 1970s. See *supra* note 41.

During the debates on the Insolvency Act, 1976, ch. 60, both the Government and the opposition were concerned about the possible effect of the Act on the use of bankruptcy as a debt collection device. See *id.*; 906 PARL. DEB. H.C. (5th ser.) 1465, 1477-79, 1488 (1976) (remarks of Mr. C. Davis and Mr. Percival).

There is no counterpart to the bankruptcy notice in the acts of bankruptcy listed in the Bankruptcy Act of 1898, ch. 541, § 3, 30 Stat. 544, 546 (repealed 1979). An undischarged judicial lien or the appointment of a receiver were the only acts of bankruptcy that the creditor could create unilaterally. Courts constructed an estoppel doctrine to prevent creditors from using acts of bankruptcy for which they were responsible as the basis of an involuntary petition. See, e.g., *In re Maryanov*, 20 F.2d 939 (E.D.N.Y. 1927) (judicial lien). See 3 COLLIER ON BANKRUPTCY ¶ 59.39 (J. Moore & L. King 14th ed. 1977).

⁴³ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 3.

⁴⁴ *Id.* § 7(1). However, secured creditors may still "realise or otherwise deal with" their security. *Id.* § 7(2). Thus, the stay effect of a receiving order is not as extensive as the automatic stay provisions of the American bankruptcy statute. Compare 11 U.S.C. § 362(a), (b) (Supp. V 1981) with Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 7.

⁴⁵ At this point in time, the debtor still has title to the property but the Official Receiver, see *infra* notes 47-50 and accompanying text, is entitled to possession of the property. *Rhodes v. Dawson*, 16 Q.B.D. 548 (1886). For a general discussion of the effect of the receiving order, see I.F. FLETCHER, *supra* note 31, at 96-99.

adjudication, there is a meeting of creditors.⁴⁶ At this meeting creditors may vote upon any plan offered by the debtor for a composition of debts. Absent acceptance of such a proposal, formal adjudication will follow. In most individual bankruptcies, this first meeting of creditors is a statutory formality—an adjudication routinely follows issuance of the receiving order.

B. *The Official Receiver and the Public Examination*

Prior to 1883, a trustee in bankruptcy selected by creditors was assigned sole responsibility for administering the bankrupt's estate.⁴⁷ The 1883 legislation significantly changed bankruptcy administration by creating the office of Official Receiver.⁴⁸ Although this governmental official did not then, and does not now, displace the private trustee,⁴⁹ the position carries substantial responsibilities, particularly in the area of discharge. Specifically, section 73 of the Bankruptcy Act of 1914 provides:

As regards the debtor, it shall be the duty of the official receiver—

(a) to investigate the conduct of the debtor and to report to the court, stating whether there is reason to believe that the debtor has committed any act which constitutes a misdemeanour under this Act . . . or which would justify the court in refusing, suspending or qualifying an order for his discharge

(c) To take part as may be directed by the Board of Trade in the public examination of the debtor⁵⁰

The public examination⁵¹ is a distinctive and controversial feature of the English bankruptcy process. The debtor, standing in the witness box⁵² and usually unrepresented by counsel,⁵³ is examined in open

⁴⁶ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 13(1).

⁴⁷ See An Act to consolidate and amend the Law of Bankruptcy, 32 & 33 Vict., ch. 71, § 14(1) (1869).

⁴⁸ I. CRUCHLEY, A HANDBOOK ON BANKRUPTCY LAW AND PRACTICE 2-3 (2d ed. 1964); Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 230 (1976); CORK, FINAL REPORT, *supra* note 28, ¶¶ 49-52. The creation of the office of the Official Receiver was prompted by criticism of the trustee system. *Id.*

⁴⁹ There are, however, situations in which the Official Receiver may also serve as trustee. See, e.g., Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 129, amended by Insolvency Act, 1976, ch. 60, § 1(1), sched. 1, pt. I (property of the debtor not in excess of £4000). See also WILLIAMS & HUNTER, *supra* note 27, at 102; CORK, FINAL REPORT, *supra* note 28, ¶¶ 684-690.

⁵⁰ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 73.

⁵¹ *Id.* § 15.

⁵² In both the public examination and the discharge hearing, the debtor stands in the witness box unless, on account of illness or infirmity, the court permits her to sit. Being so exposed to the spectators, the judge, and the Official Receiver must increase the sense of helplessness which many debtors doubtlessly experience.

⁵³ But see *infra* text accompanying notes 129-32 (Hearing Number Five). Legal Aid is avail-

court concerning the affairs and events that led to the bankruptcy. This examination, which is held as soon as possible⁵⁴ after the debtor has supplied the Official Receiver with a statement of affairs, is justified on several grounds. Writing in 1975, Justice (a committee of the British Section of the International Commission of Jurists) suggested four historical reasons for the institution:

- (a) Investigatory, *i.e.*, to discover the true state of the bankrupt's affairs and the causes of his failure, [and] to locate his assets . . . [that] are capable of being recovered by the trustee in bankruptcy for the general body of creditors.
- (b) Informative, *i.e.*, to acquaint the creditors as well as the public at large with the circumstances of the bankruptcy, to give an opportunity to those creditors to question the debtor and also, through publicity, to make known to other creditors, whose existence may not have been disclosed by the debtor or otherwise come to light, the fact that bankruptcy has taken place.
- (c) Protective, *i.e.*, to warn potential future creditors of the bankrupt's previous conduct and also, through the publicity attaching to the examination, to have a deterrent or perhaps reformatory effect upon members of the trading community, in particular by improving the standards of commercial practice and integrity.
- (d) Precautionary, *i.e.*, to ascertain whether the bankrupt ought ever to be relieved of those disabilities which are imposed upon him by virtue of his status as a bankrupt and also from the stigma to which such status still appears to expose him in the eyes of society generally.⁵⁵

Much of the questioning in the public examination relates to the causes of the debtor's bankruptcy. One of the Official Receiver's main concerns is to establish the existence of any facts that will have to be considered when the debtor later applies for a discharge.⁵⁶ The bankruptcy statute provides that once the oath is administered, it shall be the debtor's duty

to answer all such questions as the court may put or allow to be put to him. Such notes of the examination as the court thinks

able to some debtors involved in bankruptcy proceedings but few can or do take advantage of it. JUSTICE, BANKRUPTCY 32-33 (1975).

⁵⁴ I.F. FLETCHER, *supra* note 31, at 111.

⁵⁵ JUSTICE, *supra* note 53, at 18-19.

⁵⁶ The significance of these facts is discussed *infra* text accompanying notes 79-82. The bankrupt's concurrence in the Official Receiver's conclusion that certain facts have been established can be used against him at a later date. See *infra* text accompanying notes 119-22 (Hearing Number Three).

proper shall be taken down in writing, and shall be read over either to or by the debtor and signed by him, and may thereafter, save as in this Act provided, be used in evidence against him⁵⁷

The debtor may not refuse to answer on the ground that the answer will be self-incriminating,⁵⁸ although in appropriate cases the court has the authority to adjourn the public examination until related criminal proceedings against the bankrupt have been concluded.⁵⁹

The public examination, which must be a terribly humiliating experience even when no spectators are in the courtroom, dramatically brings home to the debtor the fact that, until she receives her discharge, she is a second class citizen.⁶⁰ She is specifically asked questions at the close of the public examination which test her knowledge of the disabilities imposed upon an undischarged bankrupt. And she is asked whether, and to what extent, she is willing to make so-called voluntary payments out of postpetition earnings for the benefit of her creditors. The debtor who claims inability to make such payments may be warned by the court that failure to do so will have an adverse effect upon her eventual application for a discharge. The bankruptcy discharge is often, in effect, purchased by postpetition payments, and the public examination provides a good opportunity for alerting the debtor to the realities of her situation.

There have been criticisms of the public examination and proposals that its use be sharply curtailed. Justice summarized several arguments against the practice:

(a) The examination is frequently no more than a formality, a waste of time and quite unnecessary in that it elicits no . . . useful information

(b) It is unjustifiably costly, in particular, having regard to the time and energy devoted to its preparation by the Official Receiver and his staff, on the one hand, and the lack of any worthwhile information obtained thereby, on the other, both in relation to the recovery of assets and regarding the true causes of the bankrupt's failure.

(c) The debtor is given no real opportunity at the examination to defend himself, the occasions on which he will be legally represented . . . being rare

. . . .

(h) The public examination has outlived any usefulness it may

⁵⁷ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 15(8).

⁵⁸ *In re Paget* [1927] 2 Ch. 85.

⁵⁹ Bankruptcy Rules, 1952, STAT. INST. 1952 NO. 2113, R. 192A.

⁶⁰ See *infra* notes 69-75 and accompanying text.

once have been thought to possess and it is no longer necessary to expose bankrupts to the indignity which it occasions.⁶¹

Accordingly, Justice proposed that

in cases where the unsecured liabilities disclosed by the debtor in his Statement of Affairs are less than £10,000, . . . the present law should be altered and . . . there should be no public examination unless (i) the court is satisfied upon the application of the Official Receiver, the trustee in bankruptcy or a creditor, that such a hearing should take place, or (ii) the debtor has been bankrupt on a previous [sic] occasion.⁶²

An outsider, interested in the process by which a debtor receives a discharge, may not share Justice's view that the public examination is often nonfunctional. As we will see shortly, most debtors accept the fact that they must pay for their freedom.⁶³ It is likely that the humiliating public examination is not an insignificant factor contributing to the willingness of debtors, as a class, to pay without protest whatever is necessary to purchase their discharge. It may not produce much useful information, but it provides an excellent vehicle for warning the debtor that payment is expected. It is doubtful that the same warning delivered in another fashion, such as by letter or by the Official Receiver outside the courtroom, would have as great an impact upon the debtor. In a sense, the public examination alerts the debtor as to what will happen much later when the discharge hearing is held.

The Insolvency Act of 1976, which followed the Justice study by one year, did not adopt these recommendations. Instead, it permits discretionary dispensation with the public examination upon application by the Official Receiver.⁶⁴ In the High Court few applications appear under this statute, and public examinations remain the rule rather than the exception.⁶⁵

C. *The Status of Debtors Prior To and Following Discharge*

The status of both undischarged and discharged bankrupts differs greatly under the American and English systems. In the United States,

⁶¹ JUSTICE, *supra* note 53, at 19. See also I.F. FLETCHER, *supra* note 31, at 113-14.

⁶² JUSTICE, *supra* note 53, at 21.

⁶³ See *infra* notes 104-35 and accompanying text.

⁶⁴ Insolvency Act, 1976, ch. 60, § 6.

⁶⁵ For example, during 1979 there were 705 public examinations in the High Court and only 30 orders dispensing with public examination. There was a much greater inclination to dispense with the public examination in the county court. One thousand two hundred and eleven orders were made dispensing with the examination while 2,972 examinations were held. LORD CHANCELLOR'S DEPT., JUDICIAL STATISTICS: ENGLAND AND WALES, CMD. 7977 (1979) (Tables C.3(b), (c)).

the debtor's postpetition earnings may not be taken by the trustee to pay the claims of creditors participating in the bankruptcy proceedings.⁶⁶ Exactly the opposite is true in England and Wales: until the discharge is granted, the trustee⁶⁷ is entitled to reach the debtor's postpetition earnings and apply them to the payment of her obligations.⁶⁸ This rarely occurs, though, because most debtors earn only enough to meet their daily living expenses. But the option to reach postpetition earnings for the benefit of prepetition creditors remains a possibility. Also, the bankrupt is usually urged during the public examination to make periodic payments to the Official Receiver until the discharge is granted. Because it is virtually impossible for a debtor to obtain an immediate and absolute discharge, bankruptcy in England is an integral part of, not an alternative to, the debt collection process.

The harsh attitude toward discharge manifests itself in other ways: an undischarged bankrupt cannot be elected to or sit or vote in either House of Parliament;⁶⁹ while undischarged, a debtor cannot be elected to, or act as, a member of a local authority;⁷⁰ nor may she hold a solicitor's practicing certificate;⁷¹ and, an undischarged bankrupt cannot act as a corporate director or as a corporate manager without leave of the court.⁷² Moreover, the bankrupt's disqualification from holding public office continues for an additional five years beyond discharge unless a court orders otherwise.⁷³ And finally, section 155 of the Bankruptcy Act of 1914 declares guilty of a misdemeanor any undischarged bankrupt who

(a) either alone or jointly with any other person obtains credit to the extent of fifty pounds or upwards from any person without informing that person that he is an undischarged bankrupt; or (b) engages in any trade or business under a name other than that under which he was adjudicated bankrupt without disclosing to all persons with whom he enters into any business transaction under the name under which he was adjudicated bankrupt.⁷⁴

⁶⁶ With a few exceptions, which do not include earnings, the trustee is only entitled to property owned by the debtor at the date of petition. 11 U.S.C. § 541 (Supp. V 1981). Of course, creditors holding nondischargeable claims are entitled to engage in postpetition collection activity.

⁶⁷ If no trustee is appointed, the Official Receiver may appoint one.

⁶⁸ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, §§ 38(2)(a), 51.

⁶⁹ Bankruptcy Act, 1883, 46 & 47 Vict. ch. 52, § 32.

⁷⁰ Local Government Act, 1972, ch. 70, § 80(1)(b).

⁷¹ Solicitors Act, 1974, ch. 47, §§ 12, 15.

⁷² Companies Act, 1948, 11 & 12 Geo. 6, ch. 38, §§ 187, 367.

⁷³ The disqualifications continue for the five-year period unless the debtor receives a certificate of misfortune pursuant to Bankruptcy Act, 1883, 46 & 47 Vict., ch. 52, § 32(2), or Local Government Act, 1972, ch. 70, § 81(1)(b). In practice, few certificates of misfortune are granted. WILLIAMS & HUNTER, *supra* note 27, at 133-34. Some modification of these disabilities has been suggested. See CORK, FINAL REPORT, *supra* note 28, ¶¶ 1838-1853.

⁷⁴ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 155, amended by Insolvency Act, 1976, ch.

It is true that many of these disqualifications do not affect the lives of most debtors: for instance, few members of Parliament will be involved in bankruptcy proceedings.⁷⁵ Still, the disqualifications do evidence a generally held view that bankruptcy is a most serious matter. This attitude is also displayed in the rules governing discharge.

D. *Eligibility for Discharge*

English discharge policy is somewhat more complicated than that currently prevailing in the United States. An English court is not limited to granting or denying a discharge.⁷⁶ The Bankruptcy Act of 1914 permits the discharge to be granted subject to a period of suspension, or the court may

refuse the discharge; or . . . require the bankrupt as a condition of his discharge to consent to judgment being entered against him by the official receiver or trustee for any balance or part of any balance of the debts provable under the bankruptcy which is not satisfied at the date of the discharge, such balance or part of any balance of the debts to be paid out of the future earnings or after-acquired property of the bankrupt in such manner and subject to such condition as the court may direct; but execution shall not be issued in the judgment without leave of court, which leave may be given on proof that the bankrupt has since his discharge acquired property or income available towards payment of his debts.⁷⁷

The statute confers on the court the power to refuse, condition, or suspend the discharge without restriction and without guidance as to how these powers are to be exercised.⁷⁸

Much in the fashion of the American statute,⁷⁹ the English act lists a number of examples of debtor misconduct, referred to as "facts," which strongly influence courts in deciding whether, and what type of, a discharge should be granted. The most commonly established facts are:

(1) that the bankrupt's assets [do not equal at least fifty per cent of his unsecured liabilities unless he establishes that this situation] has arisen from circumstances for which he cannot justly be held responsible.

60, § 1(1), sched. 1, pt. I.

⁷⁵ For the discussion of one recent case involving a former member of Parliament see *infra* text accompanying notes 129-32 (Hearing Number Five).

⁷⁶ Cf. 11 U.S.C. § 727 (Supp. V 1981) (American courts are so limited).

⁷⁷ Bankruptcy Act of 1914, § 26, *supra* note 18.

⁷⁸ See *infra* note 109 and accompanying text.

⁷⁹ 11 U.S.C. § 727 (Supp. V 1981).

(2) That the bankrupt has omitted to keep such books of account as are usual and proper in the business carried on by him and as sufficiently disclose his business transactions and financial position within the three years immediately preceding his bankruptcy. . . .

(3) That the bankrupt has continued to trade after knowing himself to be insolvent. . . .

(4) That the bankrupt has failed to account satisfactorily for any loss of assets or for any deficiency of assets to meet his liabilities. . . .

(5) That the bankrupt has brought on, or contributed to, his bankruptcy by rash and hazardous speculations, or by unjustifiable extravagance in living, or by gambling, or by culpable neglect of his business affairs.⁸⁰

In America, any findings of debtor misconduct or ineligibility for discharge will lead to a denial of discharge. In England, the effect is less clear-cut. Strictly speaking, the presence of statutory facts is relevant only to the determination of whether the court will grant an absolute order of discharge; if a statutory fact is found, denial, suspension, or condition of the discharge become the court's only alternatives. But, in reality, the presence of facts obviously influences the relief granted by the court and is usually mentioned when the decision is announced.⁸¹ Some facts are regarded as being more serious than others. For instance, the failure to keep proper books and continuing to trade after knowledge of insolvency are regarded as especially serious facts.⁸² The number and seriousness of the facts established assist the court in determining the appropriate form of relief.

E. *The Discharge Hearings*

1. Application by the Debtor

The debtor may apply for a discharge at any time after the public examination has been concluded.⁸³ The court will hold a hearing on this application after appropriate notice is given to creditors.⁸⁴ At the discharge hearing, the Official Receiver presents to the court a report that includes an evaluation of the causes of the debtor's bankruptcy and

⁸⁰ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26(3).

⁸¹ They are also significant at the appellate level. *See, e.g., In re Smith* [1947] 1 All E.R. 769.

⁸² WILLIAMS & HUNTER, *supra* note 27, at 129-30.

⁸³ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26(1).

⁸⁴ Although creditors may be heard at the hearing, they rarely attend. Ordinarily, the only persons in attendance are the debtor, the Official Receiver, the judge (or a "registrar," *see supra* note 31), court staff, and occasionally, a bankruptcy trustee.

a report on whatever cooperation has been offered by the debtor, including the marking of voluntary payments between the date of the public examination and the date of the discharge hearing. This report is very influential in shaping the court's attitude toward the debtor:

The Official Receiver's findings of fact, and his recommendations based thereon, are . . . of foremost significance and generally carry great influence, since they are made by an officer of the court. Moreover the Act specifically provides that the report shall be *prima facie* evidence of the statements it contains, and hence it is incumbent upon the bankrupt to mount a successful challenge to any adverse statements if they are not to stand to his disadvantage.⁸⁵

After the Official Receiver's report has been read, the debtor is called to the witness stand and is placed under oath. The questioning by the Official Receiver will focus on the debtor's activities since entry of the receiving order and her present financial status. She may be asked why she wishes a discharge. She will always be asked whether she is willing to make payments out of future earnings for the benefit of her creditors. If she promised at her public examination to make voluntary payments and did not in fact do so, she will be asked to explain this default.

Most debtors behave in a very docile fashion at this hearing; they are anxious to obtain a discharge and do not want to do anything that will jeopardize their chances. Occasionally, a debtor will take issue with the Official Receiver's characterization of her prebankruptcy conduct, arguing, for instance, that she did not engage in rash and hazardous speculation. Such recalcitrance will be quickly stifled by a reference to the transcript of the public examination.⁸⁶ The debtor will be reminded that she admitted the existence of statutory facts at that time. Most of the evidence used against the debtor at the discharge hearing is derived from, or obtained through, the debtor's answers at the public examination.

Prior to the debtor's exit from the witness stand she will be asked to make a specific offer for the benefit of her creditors. She may state that she is unable to afford anything, or she may offer a specific sum such as £5 per week for two years. The court will then ask the Official Receiver for a reaction to this offer. The Official Receiver's position concerning the adequacy of the offer is very significant but not dispositive. The court may approve the plan of payment suggested by the Offi-

⁸⁵ I.F. FLETCHER, *supra* note 31, at 286 (footnote omitted).

⁸⁶ See, e.g., *infra* text accompanying notes 119-22 (Hearing Number Three).

cial Receiver, or may implement a different one. If the court is considering suspending the discharge, the Official Receiver will be consulted as to the appropriate suspension period. Then, unless there is reason to adjourn the hearing,⁸⁷ the court will immediately announce its decision.

2. Automatic Review and Automatic Discharge Under the Insolvency Act of 1976

Debtors in England and Wales must often struggle to obtain their discharges. Not surprisingly, therefore, many debtors simply fail to apply for discharge. This feature of the English bankruptcy system was criticized as early as 1957,⁸⁸ when it was suggested that bankrupts should be granted an automatic discharge two years after the conclusion of the public examination unless the court specifically found that an automatic discharge was inappropriate. Almost twenty years after this suggestion was made, the Insolvency Act of 1976 was enacted. It contains a provision that empowers the bankruptcy court, either at the conclusion of the public examination or when it makes an order dispensing with such examination, to grant the debtor an automatic discharge that will become effective in five years.⁸⁹ Since this authorization has only a prospective effect, the Insolvency Act of 1976 also requires the Official Receiver to bring forward for review cases of all prior undischarged bankrupts after five years have elapsed.⁹⁰

3. Disposition of Cases

Unconditional discharges are a rarity. During 1979, the last year for which statistics are available, only slightly more than four percent of the bankrupts (29 of 666) received unconditional discharges.⁹¹ The automatic review process authorized by the Insolvency Act of 1976 produces a somewhat more favorable figure: Over one half of these dispo-

⁸⁷ See, e.g., *id.*

⁸⁸ BOARD OF TRADE, BANKRUPTCY LAW AMENDMENT COMMITTEE, REPORT OF THE COMMITTEE ON BANKRUPTCY LAW AND DEEDS OF ARRANGEMENT LAW AMENDMENT, CMD. 221, at 20-21 (1957). See also JUSTICE, *supra* note 53, at 25-26 (failure of bankrupts to seek discharge is "one of the most disquieting features of the present" English bankruptcy system).

⁸⁹ Insolvency Act, 1976, ch. 60, § 7. This prospective grant of a discharge is without prejudice to the debtor's right to apply for a discharge at an earlier date. The automatic discharge will be granted only if there is no substantial debtor misconduct.

⁹⁰ *Id.* § 8.

⁹¹ The statistics for the period 1974-79 are as follows:

sitions (1178 of 2263) resulted in an unconditional discharge.⁹² There are two reasons for the greater percentage of unconditional discharges in this second category. First, the court has complete discretion to grant an unconditional discharge in automatic review hearings even if statutory facts are present.⁹³ Second, five years have elapsed since the debtor's bankruptcy adjudication, and the passage of time no doubt encourages clemency.⁹⁴ But the fact remains that over the years the vast majority of all discharges are granted subject to conditions and/or a period of suspension.⁹⁵ The unconditional discharge is the exception, not the rule, in England and Wales.⁹⁶

F. *Effect of Discharge*

The English bankruptcy process makes extensive use of techniques of condition and suspension to carry out discharge policy. But the discharge, when finally granted, is rather fully effective. It discharges the debtor from all provable⁹⁷ prepetition claims, with three exceptions:

	1974	1975	1976	1977	1978	1979
Dispositions	722	787	799	724	773	666
Refused	78	82	113	80	102	108
Adjourned generally	25	15	12	18	14	11
Withdrawn	15	10	10	11	16	3
Unconditional discharge	15	12	10	22	38	29
Conditional discharge	155	176	209	168	227	210
Conditional suspended discharge	233	232	201	222	229	153
Suspended	201	260	244	203	147	152

DEPARTMENT OF TRADE, BANKRUPTCY: GENERAL ANNUAL REPORTS (1974-79) (Table 7).

⁹² LORD CHANCELLOR'S DEPT., JUDICIAL STATISTICS: ENGLAND AND WALES, CMD. 7977 (1979) (Table C.3(c)).

⁹³ Insolvency Act, 1976, ch. 60, § 8(6)(a).

⁹⁴ A principle of self-selection may also be at work. Perhaps swindlers and intentional abusers of the credit-granting process are impatient and apply for a discharge before the five years have elapsed. Because the automatic review procedure applies only when there has been no prior application for a discharge, *id.* § 8(1)(a), automatic discharges may involve less culpable conduct.

⁹⁵ Viewed realistically, an unconditional discharge granted under the automatic review process is the same as a discharge granted subject to a five-year period of suspension. Thus, the figures for unconditional discharge under the automatic review process overemphasize the leniency of the process.

⁹⁶ Another factor helps understate the restrictiveness of discharge policy when compared with that prevailing in the United States. In this country, the bankruptcy discharge ordinarily will be granted in the first few months of the bankruptcy proceedings. See 11 U.S.C. app.—Bankr. R. 404 (1976). And there are only a few situations in which property acquired by the debtor following commencement of the proceedings will be taken in satisfaction of creditors' claims. See 11 U.S.C. § 541(a)(5) (Supp. V 1981). In England all of the debtor's postpetition assets are theoretically subject to seizure, see *supra* note 68 and accompanying text, and the debtor does not routinely receive a discharge in the early stages of the proceeding. Even the unconditional discharge is not received until after a substantial period of time has passed. See *supra* text accompanying notes 43-46.

⁹⁷ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 30. The concept of provable claims operates

certain tax and penal obligations, liabilities incurred by means of fraud or fraudulent breach of trust, and certain matrimonial debts.⁹⁸

Generally, we can say that in both England and the United States, exceptions from discharge exist to protect creditors with claims of special merit⁹⁹ against the possibility of abuse of the discharge privilege and to take care of the occasional case in which the debtor fortuitously acquires postpetition wealth.¹⁰⁰ If we truly believed that the debtor had yielded up all her property and that there was no prospect of an improvement in her financial condition, there would be no exceptions to discharge. But there is always a lingering doubt, the hope that the debtor can do something for her creditors. This leads to the creation of such exceptions. English discharge practice keeps the debtor waiting for a long period of time, and does not authorize a release without an intensive examination of the debtor's conduct and ability to pay, and frequently conditions a discharge upon the debtor's consent to pay creditors out of future income. This practice minimizes the chance that creditors will be surprised and disappointed by developments in the debtor's life following the granting of the discharge. Accordingly, it is not surprising to find fewer exceptions to discharge in England than in the United States.¹⁰¹

III. SIX DISCHARGE HEARINGS

Any discharge decision by an English court involves the exercise of an extraordinary amount of discretion, discretion that, for the most

to exclude certain creditors from any participation in the bankruptcy estate. Section 30(1) provides a list of creditors who do not hold provable claims (e.g., an unliquidated negligence claim). Most such creditors are excluded from participation because of difficulties associated with the establishment of an exact amount for the claim. Because the discharge affects only provable debts (§ 28(2)), creditors holding nonprovable claims must be added to the list of those whose collection rights survive bankruptcy.

⁹⁸ *Id.* § 28(1).

⁹⁹ The status of the creditor (e.g., former spouse) or the circumstances under which the claim was created (e.g., fraud) are both factors which may lead the legislature to create an exception to discharge.

¹⁰⁰ In the United States, only certain postpetition acquisitions of property can be claimed by the trustee for the benefit of prepetition creditors and then only in the 180 days following the filing of the petition. See 11 U.S.C. § 541(a)(5) (Supp. V 1981).

¹⁰¹ Compare *id.* § 523(a) (listing nine exceptions to discharge) with Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 28(1) (listing only three exceptions).

A bankruptcy discharge with few, if any, exceptions, may be preferred for one reason that has little to do with discharge policy. In bankruptcy proceedings, unsecured creditors are paid in order of a statutory hierarchy of priorities. See Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 33; 11 U.S.C. § 507(a) (Supp. V 1981). The creditor with a nondischargeable claim has two chances to collect: during the proceeding and following it. If successful, this creditor may eventually realize a greater recovery than a creditor holding a dischargeable claim having a higher priority. Thus, the provision of many exceptions to discharge can indirectly undercut the distribution priority established elsewhere in the statute.

part, traditionally has not been granted to American bankruptcy judges.¹⁰²

Because the discretion held by English bankruptcy judges is so broad, this part of the Article provides, so far as is possible, a detailed look at how the discretion actually is used, and should raise questions relating to how American judges and society would view such plenary authority if American law were restructured.¹⁰³ It is possible to state, but only in the most general terms, the principles that control the exercise of this discretion:

The Act itself lays down no explicit guidelines to indicate what are the objectives to be achieved through the court's controlled use of its discretionary powers in relation to discharge from bankruptcy. However, it may be logically inferred from the overall purposes attaching to the bankruptcy law that the court should be mindful of such questions as the debtor's suitability to recommence trading; whether the creditors have been enabled to recover all that might reasonably be made forthcoming to them through the bankruptcy; and the essential consideration of the proper protection of the public. Against such considerations must be balanced the need to avoid placing such a lingering burden upon the debtor as to destroy all motive for future exertion on his part, for it is a fundamental policy of the bankruptcy law that, in return for giving up his property, the debtor shall be made a free man again. Likewise it would be regarded as unfair to accompany a refusal of discharge with a formulation of conditions as to the future payment of money to so great an amount that there is no reasonable chance that the bankrupt will ever qualify for his discharge.¹⁰⁴

The sole power to determine debtor eligibility for discharge has resided with the court since 1883. Prior to that time it had been held by creditors alone¹⁰⁵ or shared with the court.¹⁰⁶ The Bankruptcy Act of 1883¹⁰⁷ gave the court complete control over the discharge because creditors had improperly exercised their power to regulate the grant of discharge.¹⁰⁸ By the beginning of the twentieth century, it was quite clear that appellate courts would intervene only in cases of extraordi-

¹⁰² See *supra* text preceding note 9. See *infra* notes 224-27 and accompanying text.

¹⁰³ See *infra* text accompanying notes 166-231.

¹⁰⁴ I.F. FLETCHER, *supra* note 31, at 289-90 (footnotes omitted).

¹⁰⁵ An Act to prevent the committing of frauds by Bankrupts, 5 Geo. 2, ch. 30, § 10 (1732).

¹⁰⁶ An Act to consolidate and amend the Law of Bankruptcy, 32 & 33 Vict., ch. 71, § 48 (1869).

¹⁰⁷ An Act to amend and consolidate the Law of Bankruptcy, 46 & 47 Vict., ch. 52, § 28 (1883).

¹⁰⁸ See S.W. DUNSCOMB, *Bankruptcy, A Study in Comparative Legislation*, in 2 STUDIES IN HISTORY, ECONOMICS AND PUBLIC LAW 150 (1893).

nary abuse of this discretion.¹⁰⁹ The last reported challenge to the discretionary exercise of the discharge power occurred thirty-five years ago.¹¹⁰ The issue before the Court of Appeal at that time was whether an excessively long period of suspension had been imposed. The action of the trial court was approved, and the standard of appellate review articulated by Lord Green made reversal of trial courts difficult:

Counsel for the bankrupt urged that the length of the suspension is unconscionably severe, because it would result in 10 years elapsing between the adjudication and the final discharge No rule as to length of period, for the purpose of judging its severity, can, I think, be laid down so as to be applicable to every class of case. One has to look at the whole circumstances of the bankruptcy and see whether the date to which the discharge of the bankrupt is ultimately remitted is excessively remote. There, again, I think it is a question of discretion, subject to this, that the court will always interfere where it comes to the conclusion that the discretion has been unconscionably exercised in the matter of the length of the suspension Every case has to be decided on its merits. Whether or not I personally should have imposed such a long period is neither here nor there. It is sufficient for me to say that the period which the registrar thought fit is not one that, in my opinion, is so unconscionable as to justify us in interfering with his discretion.¹¹¹

Little is generally known about how the trial court decides what condition and/or period of suspension is appropriate. Appellate decisions are few in number and, as in the opinion just quoted, are usually confined to an approval in the most general terms of the lower court's ruling. Furthermore, there is no bankruptcy service in England that reports decisions at the trial level. One recent and particularly notorious bankruptcy adjudication, however, provides a rare and interesting insight into the English decisionmaking process. On June 21, 1977, Mr. Registrar Hunt granted a discharge to one William Jack Godfrey, a property developer and spare-time pig farmer with debts of approximately £27,000,000. This discharge was subject to a period of suspension of five months and a condition of payment of £2000 in two annual installments of £1000. The judge's remarks were so extensive that they

¹⁰⁹ *In re Shaw*, [1917] 2 K.B. 734 (suspension of discharge for period of two years held proper exercise of discretion); *In re Chase*, 3 Morrell Bankr. Cas. 228 (1886) (three-month suspension a proper exercise of discretion). The fact that appellate courts would give the bankruptcy judge a free hand was anticipated by one critic who feared that the debtor's treatment would be too lenient. *The Government Proposals as to the Discharge of Bankrupts*, 27 SOLIC. J. 443 (1883).

¹¹⁰ *In re Smith*, [1947] 1 All E.R. 769.

¹¹¹ *Id.* at 771.

were reproduced in the August 1977 issue of *The Banker*¹¹² and deserve repetition here. Note that even this elaboration, which the magazine's editors regarded as "a rare insight,"¹¹³ provides little information as to how Mr. Registrar Hunt determined the appropriate condition and period of suspension. We are left with the questions why the period of suspension was only five months and why Mr. Registrar Hunt imposed a condition of repayment in the amount of £2000 instead of some other sum:

The vast size of the deficiency makes it desirable to state the principles on which the court acts in granting or refusing a discharge. For if the size of the failure is a crucial factor the conclusion would seem to be that a debtor with a deficiency of this magnitude would never get a discharge at all. So what are the principles?

I think the starting point is to be found in a judgment of Mr. Vaughan Williams, a leading authority on the subject, when he said: "The over-riding intention of the legislation in all bankruptcy acts is that the debtor on giving up the whole of his property shall be a free man again, able to earn his livelihood and having the ordinary inducement to industry. Sometimes it is not right that the bankrupt should be free immediately, he must pass through a period of probation; and theoretically there may be cases where he ought not to be free at all; but *prima facie* he is to give up everything he has and in doing that he is to be made a free man."

Now what is the position of the bankrupt in this case? If I thought there was any tangible expectation of his receiving a larger income than that which is necessary for his support in his position in life I should see the propriety of suspending his discharge for a longer period or even of setting aside some portion of his income.

As to the circumstances which may affect the application of this principle, the Bankruptcy Act lists a number of facts . . . the existence of which precludes the court from granting an unconditional discharge. . . .

It is, however, significant that the legislation does not provide that the court should take into account the absolute size of the deficiency. This does not, in my judgment, mean that the size of the deficiency is wholly immaterial. . . . [W]hen there is a very large deficiency, I think the court should subject the causes of failure to particularly careful scrutiny, before discharging the debtor, in order to satisfy itself that his conduct has not been open to serious criticism.

As it appears from the judgment I quoted, in considering

¹¹² 127 THE BANKER (LONDON) NO. 618, at 139-40 (AUG. 1977).

¹¹³ *Id.* at 139.

whether, and if so on what terms, to discharge a bankrupt, two main questions usually arise.

1. Whether the conduct of the bankrupt has been such that the public ought to be protected against his further operations for a period of time, or even permanently, and

2. whether he is likely to be able to make some financial contribution towards his debts.

In dealing with the first question, it may often be felt that the mere fact of having undergone the somewhat traumatic experience of bankruptcy is itself a sufficiently sharp lesson to ensure that the individual will be more careful in future. On the other hand it may be that to prolong the disability by a period of suspension is desirable to reinforce the lesson, and to draw some distinction between more and less serious cases.

As regards the question of contribution, it will often be the case that the deficiency is so large that no contribution which it would be reasonable to expect will have any material impact for the creditors. But this does not mean that no contribution should be required from a bankrupt who is in a position to make one. Bankruptcy is not intended to be a soft option, and a genuine attempt to do what one can to repair the damage is likely to inspire greater confidence that the debtor will behave responsibly in the future. . . .

[The Registrar at this point referred to events leading up to the bankruptcy of Mr. Godfrey, the money his companies borrowed, the personal guarantees he gave on behalf of the companies and the collapse of the property market.]

Now I think there are a number of comments to be made about this. First, it must be said that if the bankrupt was at fault in misjudging the future course of the property market, he was in good company. A great many other people made the same misjudgment, including, be it noted, his main creditors. He did not raise funds he needed from innocent members of the public, who relied on his judgment, but from professionals who were just as well qualified as the bankrupt to judge the soundness of his schemes. If, with all their resources of expertise, they were prepared to advance the funds for the bankrupt's operations, I do not think they can be heard to say that they relied entirely on his judgment. Nor in fact has any of them, so far as I am aware, suggested otherwise.

Secondly I note that none of these creditors has come forward to complain of the bankrupt's conduct. If they had come and complained that he had misled them about material factors, the position might be very different. And, bearing in mind the very large losses which some of them seem not unlikely to incur, I think it is of some significance that none has come forward to complain.

It is also worth noting that the receiver was happy to employ

the bankrupt to manage the companies' affairs, so that he was presumably satisfied with his competence, and there has been no criticism from the receiver of the state of the companies' books and records when he took over.

It follows, in my judgment, that the failure of these companies, which is the cause of the bankruptcy, cannot be said to be due to any culpable mismanagement or misconduct by the bankrupt. This is not, of course, to suggest that he is entitled to a certificate of misfortune. He chose to embark on very large-scale operations, involving inevitable risks and to incur personal liability by giving guarantees, which he could not hope to meet; and to that extent he is the author of his own downfall. But I accept his claim that the financial institutions whose debts he guaranteed could not realistically have believed that he could pay them. I have no doubt that they asked for the guarantees simply in order to ensure that the debtor was fully committed himself, and therefore unlikely to play ducks and drakes with the companies' fortunes.

[The Registrar here referred to the debtor's farming operations which resulted in a 'substantial deficiency.'] But the fact is that it was started more as a hobby than as his main business, and until the disaster in the property business he could well afford to take the losses in the farm, and creditors were in no real danger.¹¹⁴

The paucity of available information concerning how the bankruptcy discharge process functions in England will frustrate anyone used to the avalanche of information on bankruptcy topics in the United States. At the same time, the situation in England is quite understandable. As the preceding example demonstrates, judicial comments of much substance are rare. There is no substantial demand for information about the way in which appropriate conditions and periods of suspension are determined. Lawyers and accountants would be the principal consumers of such information. Because debtors are not usually represented by solicitors or barristers at the time they seek a discharge, there is little demand for such information. Accordingly, attendance at a number of discharge hearings is the only practical way for an outsider to acquire any understanding of how the discharge process operates. The six cases which follow are not representative of what one might observe by attending bankruptcy court on any particular day. Indeed, one case involves a very unusual set of facts. But they do illustrate how the bankruptcy system actually functions.¹¹⁵

¹¹⁴ *Id.* at 139-40.

¹¹⁵ These cases are based on notes taken when I attended discharge hearings at County Court in Croydon, England and Cardiff, Wales, and at the High Court in London, between Feb. 1 and July 15, 1980.

A. *Hearing Number One: The Repeater*

This is the third bankruptcy for the debtor. Twice before, once in the early 1960's and then a decade later, he has received a discharge. Now in his late fifties, he is once again asking the court for relief. He stands in the witness box and is examined under oath by the Official Receiver. His testimony reveals that he is a free-lance technical consultant earning about £1500 per year. He states that he believes that he can immediately double his income if he is given a discharge. (In England, the stigma of bankruptcy is far greater than it is in the United States and the lack of discharge can be a serious impediment to professional advancement.) The court and the Official Receiver accept his characterization of the situation. In response to a question put by the Official Receiver, he admits that his creditors will receive less than a ten percent dividend unless further assets are made available. The Official Receiver wants to know whether the debtor is willing to make further payments as a condition of obtaining his discharge. The answer is yes. One thousand pounds to be paid out of future income over a two-year period would be a manageable sum. Not satisfied with this amount, the Official Receiver asks whether it could be raised to £2000. Before the debtor can respond, the court intervenes. What about £5000 over a longer period of time? The debtor says he can manage this sum and the Official Receiver indicates satisfaction with the larger amount. The court then grants the discharge subject to the condition that the debtor (who has no dependents) pay £5000 in five annual installments of £1000.

Comment: This is an interesting case for several reasons. It illustrates the stigma that may be felt by those persons who are undischarged bankrupts. Here the debtor was able to convince the court that his status was impeding his professional advancement. The court accepted this contention but then took an active role in the process of determining how much the debtor could pay for the privilege of obtaining his discharge. It is unclear how the court arrived at the sum of £5000. Neither the Official Receiver nor the debtor offered any fact that the court used to justify its award. A decision can be made in this fashion only if the bankruptcy system allows the trial court almost complete freedom to fix the terms of a conditional discharge or to determine the appropriate length of a suspension.¹¹⁶

¹¹⁶ See *supra* note 109 and accompanying text.

B. *Hearing Number Two: A Suspended Discharge*

This is the second bankruptcy for the debtor, a man approximately forty years old. The first proceeding was commenced in 1965 with a discharge being received in 1969. This one was commenced in 1974. Debts (originally understated by a third) amount to £22,000 and assets amount to only fifty-five pounds. No voluntary payments have been made by the debtor during the past six years. He has a weekly take-home pay of seventy-four pounds and must support a wife and two teenaged children. He can make no offer of future payments for the benefit of his creditors. The court then asks whether the debtor's relatives can make any payments. Again, the answer is no. Despite the fact that creditors have not received anything, the court grants a discharge subject to a period of suspension of one year but without any conditions. Two reasons are given by the court to justify the period of suspension. First, this is the debtor's second bankruptcy. Second, prior to the bankruptcy, the debtor had sold some property that was subject to a security interest without the secured party's consent and had failed to turn the proceeds over to the secured creditor.

Comment: The court was obviously convinced that there was no practical way for the debtor to produce any more money, so the court was simply concerned with expressing disapproval of the debtor's repeat appearance in bankruptcy court and his prebankruptcy conversion of the collateral. At first glance, the one-year suspension seems rather moderate under the circumstances. Presumably the court was taking into account the fact that the debtor had already been an undischarged bankrupt for six years at the time of the hearing.

An American bankruptcy judge is given different tools to deal with the problem of repeated bankruptcies and prebankruptcy conversion of collateral. A repeater is not entitled to more than one discharge in liquidation proceedings every six years,¹¹⁷ but a judge would not be entitled to deny a discharge for prebankruptcy conversion of collateral, although it is possible that this transaction might create a nondischargeable obligation.¹¹⁸ The American bankruptcy judge also

¹¹⁷ 11 U.S.C. § 727(a)(8) (Supp. V 1981). The six-year rule is not applicable if the debtor files a voluntary petition under Chapter 13. *Id.* § 1328(a), (b). However, the frequency of use of Chapter 13 will be considered by the court when it determines whether the Chapter 13 plan has been filed in good faith.

¹¹⁸ 11 U.S.C. § 523(a)(6) (Supp. V 1981). See *In re Auvenshine*, 9 Bankr. 772 (Bankr. W.D. Mich. 1981) (sale of appliances subject to security interest is "willful and malicious" within the meaning of 11 U.S.C. § 523(a)(6) and therefore debt is non-dischargeable). But see *In re Holdges*, 4 Bankr. 513 (Bankr. W.D. Va. 1980) (sale of stereo subject to security interest, although "willful," was not "malicious" within the meaning of 11 U.S.C. § 523(a)(6) where sale was not intended to harm creditor, and debtor intended eventually to pay creditor if he was able,

has no power to suspend a discharge for the purpose of expressing disapproval of the debtor's conduct.

C. *Hearing Number Three: "Unjustifiable Extravagance in Living"*

The debtor, male and slightly over thirty, is seeking a discharge from personal debts amounting to nearly £12,000 even though no distribution has been made to his creditors. The twelve pounds in assets which he turned over to the Official Receiver has been used to pay administrative expenses. Today the debtor is making £300 per month and his wife makes £389 a month. They have no children, but he testifies that they hope to start a family in the near future. His wife owns the house and makes the monthly mortgage payments of £174. They have no other debts, nor do they have any other substantial assets, not even a car. The court is also informed by the Official Receiver that, concurrent with the debtor's bankruptcy, a company controlled by the debtor became involved in insolvency proceedings. There are corporate creditors with £16,000 in unpaid claims. The Official Receiver further states that one of the precipitating causes of bankruptcy was "unjustifiable extravagance in living." This is one of the statutory facts whose presence prevents the court from granting an unconditional discharge.¹¹⁹ The debtor, from the witness box, questions the accuracy of this statement. He is reminded by the Official Receiver that, on his public examination, he admitted that he had been guilty of unjustifiable extravagance in living. To refresh his recollection, the Official Receiver reads from the official transcript of that proceeding.¹²⁰ The debtor immediately acquiesces in the conclusion of the Official Receiver, who then informs the court that he believes payment in the area of £4500 to £5000 should be required as a condition of discharge. The bankrupt responds with an offer of fifty pounds a month for three years (a total of £1800). He points out that the family monthly living expenses are £355 and when the £174 mortgage payment is subtracted only £160 of joint income remains uncommitted. The fifty-pound proposed monthly payment will have to come out of this joint uncommitted income. He reiterates his and his wife's hope to start a family. The court is not impressed with the offer. The judge is concerned that there are almost £28,000 in unpaid debts if one combines the personal and business bankruptcies. The debtor is told that he will have to do more. £1800

and therefore discharge may be granted).

¹¹⁹ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26(3)(f). See *supra* notes 76-82 and accompanying text.

¹²⁰ See *supra* notes 47-65 and accompanying text.

over a three-year period is not enough. The court adjourns the hearing for three months. The debtor is warned that he must come up with something in the area of £5000. If he does not, the application will be denied. The three-month adjournment will give the debtor a chance to reconsider his offer.

Comment: Time and again, the bankrupt's admissions during the public examination come back to haunt him. Even without such admissions, the Official Receiver's report, which includes a determination of what statutory facts are present in the case, is *prima facie* evidence of these facts.¹²¹ But the bankrupt's admissions during the public examination make the Official Receiver's position incontestable. To an observer, this may be the most troubling part of the whole discharge process. Debtors generally seem to have no idea that the admissions they make during the public examination will later be used against them at the discharge hearing. In this case, the presence of "unjustifiable extravagance in living" obviously was a significant factor in the tough stand taken by the court. If the three-month adjournment does not cause the debtor to change his mind, it is clear that the discharge will be denied. The unsuccessful debtor may apply at a later date for a rehearing.¹²² Presumably, unless the passage of time has softened the court's heart, the reapplication will not be successful unless the debtor is prepared to make a substantial payment for the benefit of his creditors.

D. *Hearing Number Four: Discharge and the Collection Process*

The male debtor, about forty-seven years of age, was adjudicated a bankrupt in August of 1978 with debts exceeding £2500. The Official Receiver states that the debtor has not fully cooperated in the administration of the estate. He has withheld information on certain business ventures in which he was a partner and has sold property belonging to the estate following the date of the petition. The Official Receiver claims that the debtor failed to keep adequate books, contracted debts without a reasonable expectation of repayment, and was guilty of culpable neglect of his business affairs.¹²³ The Official Receiver also reports that £1600 has been given to him by a third party. This sum was to be used to attempt a rescission¹²⁴ of the receiving order¹²⁵ which, for some inexplicable reason, never took place.

¹²¹ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26(6).

¹²² *Id.* § 108(1).

¹²³ These are all statutory facts. *Id.* § 26(3).

¹²⁴ *Id.* § 108(1).

¹²⁵ See *supra* text accompanying notes 43-45.

Under examination by the Official Receiver, the debtor states that he is a "rag and bone man."¹²⁶ His income fluctuates sharply from week to week but he estimates that it averages about forty pounds per week. His answers concerning this income are rather vague and he finally admits that he is still not keeping adequate books of account. He has a wife and two children, ages eight and eleven. Although separated from his wife, he tries to provide his family with £60 per week. The Official Receiver asks him whether he is prepared to add anything to the £1600 that has already been paid into court by a third party. His response is, "I'll do whatever I have to do."

An examination by the attorney for one creditor, a rather unusual occurrence, follows: "How can you afford to give your wife sixty pounds per week when you only earn forty pounds?" The debtor then admits that he has an additional business of rehabilitating old cars with an unnamed partner. This business provides extra income but his testimony on the extent of the income is rather vague. He finally tells the attorney for the creditor that he would be willing to contribute ten pounds per week. The Official Receiver expresses doubt that the debtor can handle this additional payment but the court appears willing to accept it, noting that the debtor can always ask for modification of a conditional discharge decree after two years if he encounters unanticipated difficulty in making the payments.¹²⁷

The court and counsel for the creditor then engage in a discussion of what should be done. They both obviously are of two minds. The debtor has been quite uncooperative and evasive in his testimony. On the other hand, the lump-sum payment of £1600, and the possibility of an additional £500 in 10 weekly installments paid over the next year, promise to yield substantial dividends to creditors. If the discharge is denied the eventual net recovery to creditors will be less than this amount. The creditor's attorney finally indicates that he would be satisfied with a conditional discharge calling for total payments to creditors of £2100. The court agrees and enters an order to this effect.

Comment: There is nothing in the statute that authorizes the deposit of funds by a third party for the debtor's benefit, but neither is there anything that prohibits it. Indeed, such deposits are quite common. They often come from relatives or employers who are anxious to help the debtor. In the United States, this debtor would probably not receive a discharge: His wrongful conduct prior to and during the

¹²⁶ A "rag and bone man" is a rag peddler. Cf. *Morris Plan Indus. Bank of N.Y. v. Dreher*, 144 F.2d 60, 61 (2d Cir. 1944) (itinerant "peddler of rags and old clothes" need not have maintained financial records in order to obtain a discharge).

¹²⁷ Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 26(2).

bankruptcy proceedings appears to establish several grounds for denial of discharge.¹²⁸ In England, however, his transgressions are not so damaging because he can make payments to creditors out of future income. If the creditor had objected to the discharge, it is unlikely that it would have been granted. But the deposit of £1600 would then have to have been returned to the depositor. This case most clearly demonstrates the primary orientation of the English bankruptcy system toward debt collection. Wrongful activity will not prevent the debtor from obtaining a discharge if he can pay for it, and protection of the public interest and condemnation of the debtor's uncooperative attitude are values subordinated to the creditors' pecuniary interests.

E. *Hearing Number Five: The Parliamentary Bankrupt*

Ordinarily, there are very few spectators in bankruptcy court. But the press is out in force on Friday, the thirteenth of June, 1980, to observe the discharge hearing for John Stonehouse, a former Labor M.P. and cabinet minister, who was adjudicated a bankrupt in December of 1976. In the early 1970's Mr. Stonehouse contracted debts of more than £800,000. After his business ventures collapsed, he fled England and went to the United States, where he attempted to fake a death-by-drowning off a Florida beach. Then, using fraudulently obtained passports,¹²⁹ he left this country. The authorities were not fooled and he was eventually apprehended in Australia. After his return to England he was sentenced to a seven-year jail term for theft. Released after undergoing open-heart surgery and obviously in poor health, Mr. Stonehouse is permitted to sit in the witness box during the course of his examination. The Official Receiver reports the presence of five statutory facts in this bankruptcy. It obviously is a very serious case and, because of the debtor's prior parliamentary position, a most sensitive one. The Official Receiver further reports that most of Mr. Stonehouse's assets were taken to satisfy the claims of secured creditors and little remains for those that are unsecured. The Inland Revenue Service, which has a first priority claim, has not been paid in full.

The debtor testifies that his sole income is a parliamentary pension of fifty-eight pounds. His weekly expenses are fifty-six pounds. He is not able to work but does engage in some charitable activity. He wants a discharge because being an undischarged bankrupt involves a lot of stress, which is bad for his heart.

¹²⁸ See 11 U.S.C. § 727(a)(2)(B), (a)(3), (a)(4)(A), (a)(4)(D) (Supp. V 1981).

¹²⁹ Cf. F. FORSYTH, *THE DAY OF THE JACKAL* 61-63 (1971). A helpful chronology of events is found in *The Times* (London), Aug. 7, 1976, at 2, col. 1.

Another unusual aspect of this case is the fact that Mr. Stonehouse is represented by counsel. His barrister urges a discharge for his client on grounds of health and pleads for an exercise of the court's discretion in a compassionate manner.

The Official Receiver does not oppose the application, informing the court that the debtor's heart condition probably makes it a worthless exercise to grant a conditional discharge. The court then questions the Official Receiver to make sure that he does not think that the discharge should be refused. The answer is no. After noting that no creditor has appeared in opposition to this application, the court grants a discharge subject to a nine-month period of suspension because of the seriousness of the bankruptcy. But there is no point in further punishment. As the court observes, the debtor is "a broken reed."

Mr. Stonehouse exits from the witness stand, stumbling and almost falling in his rush to leave the courtroom. He is driven away from the Law Courts in a Rolls-Royce and the *Evening Standard*¹³⁰ headlines its account of the proceeding: "Stonehouse, debts and a Rolls-Royce." But as the *Times*¹³¹ notes, the Rolls-Royce belongs to his solicitor, not to Mr. Stonehouse.

Comment: This is a striking example of how compassionate the operation of the English bankruptcy system can be. It is highly unlikely that an American bankruptcy judge would have been able to give Mr. Stonehouse a discharge.¹³² The nine-month period of suspension is a rather moderate rebuke considering the magnitude of the bankruptcy and the prominent public position of the debtor. But in both this and the immediately preceding case a discharge is granted, despite the obvious debtor misconduct, when it appears that withholding it will not produce any more assets for distribution to creditors.

F. *Hearing Number Six: Automatic Review and an Unconditional Discharge*

The debtor, age seventy-four, has appeared at an automatic discharge hearing held in accordance with the requirements of the Insolvency Act of 1976.¹³³ The Official Receiver reports that there are £1300 in debts and assets amounting to £174. In addition, the bankruptcy trustee has been able to recover £500 the debtor had transferred to his daughter prior to bankruptcy.¹³⁴ A substantial dividend can be

¹³⁰ The *Evening Standard* (London), June 13, 1980, at 5, col. 2.

¹³¹ The *Times* (London), June 14, 1980, at 3, col. 1.

¹³² See 11 U.S.C. § 727(a)(2)(A), (a)(3) (Supp. V 1981).

¹³³ Insolvency Act, 1976, ch. 60, § 7; see *supra* text accompanying notes 88-90.

¹³⁴ See Bankruptcy Act, 1914, 4 & 5 Geo. 5, ch. 59, § 42(1).

paid, although not enough to pay creditors 50 pence on the pound.¹³⁵ The Official Receiver also reports that the largest debt in the bankruptcy proceeding was an obligation of a third person for which the debtor was held vicariously responsible. This is clearly not a serious bankruptcy. It is also apparent that, at his age, the debtor will not be able to make further payments for the benefit of his creditors. No creditors have appeared to oppose the discharge; therefore, the court grants an immediate and unconditional release.

Comment: Although this is an uncomplicated case, it should be noted that the debtor has had to wait five years for the grant of the unconditional discharge. The absence of debtor misconduct, the substantial dividend paid to creditors, and the lack of future earning capacity all combined to convince the court that this is a case in which there should be no conditions upon the discharge and no period of suspension.

G. Conclusions

Two general observations need to be made about these six cases and, indeed, about the whole process of discharging bankrupts in England. First of all, the suspended and conditional discharge system is expensive to operate. Each case demands more attention than the discharge of an American debtor because the process must respond to the facts of the individual case. In the United States the debtor automatically receives a discharge unless one of the limitation rules applies. Additionally, in the vast majority of cases, parties who would like to see the discharge denied can make their own determination without invoking the judicial process to determine whether the debtor is eligible for relief. The limitation rules are simple to apply (for example, the six-year rule) and judicial participation in the discharge process is held to a minimum. Careful judicial scrutiny of the facts is required only in unusual cases. In contrast, discharge hearings in England require much more attention. It will be a rare case in which one of the statutory facts is not present. Thus, the court often is obliged to determine an appropriate period of suspension and/or condition of payment. Most hearings require an evaluation of the debtor's conduct and financial condition. The court does not develop these facts independently, so it must rely heavily on the work of the Official Receiver.

This brings us to the second observation. The Official Receiver stands at the center of the discharge process, gathering information

¹³⁵ This is one of the statutory facts. *Id.* § 26(3)(a).

about the debtor's conduct prior to the public examination, at the public examination, and at the discharge hearing. The Receiver's highly influential report and presentation during the discharge hearing are of critical importance. Together the court and the Official Receiver share the responsibility for determining what the debtor can afford to pay, how the public interest is to be served, and what degree of firmness is compatible with a basic sense of humanity. Reconciliation of these competing demands is a difficult task and a critical component of the current process. It would be possible to have a conditional/suspended discharge system without an Official Receiver—but it would not be the same system.

English bankruptcy procedure stands on a footing far different from that in the United States. In England bankruptcy law exists in part to promote debt collection, and the adjudicative system that developed around this function focuses on the debtor's particular circumstances and ability to pay. In the United States, on the other hand, debtor rehabilitation is a paramount concern, and the use of limited discharge facilitates a bankrupt's prompt return to the credit market. The next part of the Article explores why and how two bankruptcy systems with a shared heritage today exhibit such widely divergent approaches to discharge practice.

IV. NINETEENTH CENTURY CHANGES IN DISCHARGE POLICY

The rules relating to debtor discharge in England and the United States were quite similar at the beginning of the nineteenth century. The statutes of both countries contained conditional discharge provisions. According to the American Bankruptcy Act of 1800,¹³⁶ no discharge could be granted except upon the consent of two-thirds in number and amount of creditors holding claims amounting to at least fifty dollars. This provision was obviously patterned on the then-existing English requirement that no discharge issue except on the consent of four-fifths of all creditors holding claims no smaller than fifty pounds.¹³⁷ Thus, in neither country would a discharge issue unless the debtor was able to strike a satisfactory bargain with her creditors.

By the end of the century the situation had changed radically.

¹³⁶ Ch.19, § 36, 2 Stat. 19, 31, § 36 (1800), *repealed by* Act of Dec. 19, 1803, ch. 6, 2 Stat. 248. A more demanding requirement of 75% payment was required for those involved in a second proceeding. *Id.* § 57.

¹³⁷ An act to prevent the committing of frauds by bankrupts, 5 Geo. 2, ch. 30, § 10 (1732). In 1776 the rigor of this rule was tempered. After the passage of one year, a debtor not able to obtain the requisite creditor consents could still petition the lord chancellor, the lord keeper, or the lords commissioners for a discharge. An act for the relief of insolvent debtors; and for the relief of bankrupts, in certain cases, 16 Geo. 3, ch. 38, § 69 (1776).

America,¹³⁸ but not England, had substituted a limited discharge for the conditional, creditor-consent rule, and in so doing rejected the notion that the discharge was in any way linked to payments that had been made or might be made to creditors. England made no such radical change. Debtors still had to bargain for their discharge, although the ultimate authority to grant them the desired relief had passed from creditors to a bankruptcy official.¹³⁹

The creditor-consent provisions disappeared from both statutes because experience had demonstrated that they were subject to abuse. Creditors might arbitrarily withhold their consent even when it was obvious that no further payments could be made for their benefit.¹⁴⁰ Tough bargainers with decisive votes could obtain preferential treatment.¹⁴¹ A few creditors were often able to manipulate administration of the estate for their own special advantage.¹⁴² Debtors also abused the creditor-consent rule by arranging for the filing of fictitious claims which diluted the voting power of legitimate creditor interests.¹⁴³ In addition, toward the close of the century there was some recognition that the public also had an interest in the satisfactory resolution of debtor-creditor controversies and that this interest was not adequately protected by the creditor-consent rules.¹⁴⁴

All these objections supported a transfer of the discharge-granting authority from private parties to public officials, which is exactly what happened in both countries. But they do not explain why the United States took the additional step of substituting a limited discharge rule for the previously existing conditional discharge practice. This was a radical change in the bankruptcy discharge process that departed from the practice in England, previous bankruptcy practice in the United States,¹⁴⁵ and the practice under state insolvency laws that were in force during the time there was no federal bankruptcy legislation.¹⁴⁶ It

¹³⁸ Bankruptcy Act of 1898, ch. 541, § 14, 30 Stat. 544, 550; see 11 U.S.C. § 727 (Supp. V 1981) (current version of § 14).

¹³⁹ An act to amend and consolidate the Law of Bankruptcy, 46 & 47 Vict., ch. 52, § 28 (1883).

¹⁴⁰ See 195 PARL. DEB. (3d ser.) 147 (1869) (remarks of Mr. Jessel); 65 *id.* (2d ser.) at 1088 (1842) (remarks of Sir J. Graham); Welbourn, *Bankruptcy Before the Era of Victorian Reform*, 4 CAMB. HIST. J. 51, 54 (1932).

¹⁴¹ See 30 CONG. REC., pt. 1, at 603 (1898) (remarks of Sen. Lindsay); S.W. DUNSCOMB, *supra* note 108, at 150; F.R. NOEL, A HISTORY OF THE BANKRUPTCY CLAUSE OF THE CONSTITUTION OF THE UNITED STATES OF AMERICA 153 (1918).

¹⁴² CORK, FINAL REPORT, *supra* note 40, ¶ 48.

¹⁴³ Welbourn, *supra* note 140, at 55.

¹⁴⁴ See *infra* note 160 and accompanying text.

¹⁴⁵ Bankruptcy Act of 1867, ch. 176, § 33, 14 Stat. 517, 533 (repealed 1878); Bankruptcy Act of 1841, ch. 9, § 4, 5 Stat. 440, 443 (repealed 1843); Bankruptcy Act of 1800, ch. 19, 2 Stat. 19 (repealed 1803).

¹⁴⁶ Many state statutes contained creditor-consent features. See P. COLEMAN, DEBTORS AND

marked the beginning of the modern era in American bankruptcy law during which the debtor has been able to obtain a discharge without any consideration of her ability to make further payments to creditors. There is no single fact or event that explains why the United States made such a radical change in its discharge laws. Instead, several factors, including federalism, the expanding western frontier, and the development of adequate alternative debt collection devices under state law, combined to produce this result. To understand fully the impact of these factors, however, we first need to consider the origins of British bankruptcy law.

In England bankruptcy law began as collection law and continues today to be so regarded. The first bankruptcy act, appearing in 1542 during the reign of Henry VIII, recited that:

[D]ivers and sundry persons craftily obtaining into their hands great substance of other mens goods, do suddenly flee to parts unknown, or keep their houses, not minding to pay or restore to any their creditors, their debts and duties, but at their own wills and pleasures consume the substance obtained by credit of other men, for their own pleasure and delicate living, against all reason, equity and good conscience¹⁴⁷

This statute did not contain any discharge provision and none appeared in English bankruptcy law for the next 163 years. Even then, the addition of the first discharge provision in 1705¹⁴⁸ did not represent a change in the fundamental direction of bankruptcy law. The new provision was not designed to prevent collection activity but to facilitate it:

In the early eighteenth century, the harshness with which bankrupts were treated was greatly reduced by statutes which, for the first time, granted them privileges. The change has been attributed to a novel recognition that bankrupts were not always delinquent and that those who failed because of circumstances beyond their control deserve compassion and relief. Such sentiments were certainly common in the literature of their time. However, parliament had acknowledged the existence of unfortunate bankrupts in James I's reign without feeling concerned to give them concessions When introduced to parliament, in response to the notorious

CREDITORS IN AMERICA 51, 72, 84-85, 123 (1974). Such discharge rules are conditional because they grant discretion to the debtor's creditors to permit or deny the discharge. See *supra* note 17 and accompanying text.

¹⁴⁷ An Act against such persons as do make bankrupts, 34 & 35 Henry 8, ch. 4, § 1 (1542-43).

¹⁴⁸ An Act to prevent Frauds frequently committed by Bankrupts, 4 & 5 Anne, ch. 17 (1705).

frauds of Thomas Pitkyn in 1704, [the new bankruptcy statute] was intended simply to increase the penalties for dishonesty, but several M.P.s, influenced by the heavy losses recently sustained by traders as a result of French wars and storms, proposed additional clauses for the relief of honest bankrupts. These were adopted because of the conviction, previously hinted at in the 1624 act, that a law which was "all Penalty and no Reward" was self-defeating: by compelling bankrupts to relinquish all property to some creditors and then exposing them to perpetual imprisonment by others, it encouraged evasion by even traders who would otherwise be willing to cooperate. In other words, what had changed was parliament's perception not of the object of the process but of the methods by which it could be obtained¹⁴⁹

The linkage between bankruptcy law and collection law was strengthened in 1842 by the addition of the bankruptcy notice to the list of acts of bankruptcy.¹⁵⁰ In so doing Parliament provided creditors with an additional collection tool—the threat of bankruptcy sanctioned by the bankruptcy court.¹⁵¹ It is not suggested that bankruptcy, as contrasted with the issuance of a bankruptcy notice, is a preferred collection technique for most creditors. Bankruptcy is a costly process that has relatively little utility for creditors who stand on the lower rungs of the distribution ladder.¹⁵² But the commercial community's appreciation that the threat of bankruptcy can be used to its advantage has created a legal environment which, when compared to that prevailing in the United States, is relatively hostile to changes favoring debtors. To suggest that England has a different discharge policy because it is less tolerant of debt creation¹⁵³ does not satisfactorily explain the situation. It is more accurate to say that bankruptcy has been a collection device for so long that it is difficult for someone in England to appreciate the sharp distinction we draw between bankruptcy and collection law. This perception of bankruptcy has often influenced England to move cautiously in according greater protection to debtors.¹⁵⁴

¹⁴⁹ Duffy, *English Bankrupts, 1571-1867*, 24 AM. J. LEGAL HIST. 283, 286-87 (1980).

¹⁵⁰ An Act for the Amendment of the Law of Bankruptcy, 5 & 6 Vict., ch. 122, § 13 (1842).

¹⁵¹ See *supra* notes 38-42 and accompanying text.

¹⁵² Bankruptcy is, however, a collection device of considerable significance for government agencies such as the Inland Revenue Service because the bankruptcy statute provides that such claims have first priority in distribution of the debtor's assets. See CORK, FINAL REPORT, *supra* note 28, ¶ 727 (in England 30-35% of all bankruptcy petitions are filed by government agencies).

¹⁵³ See, e.g., Joslin, *Bankruptcy: Anglo-American Contrasts*, 29 MOD. L. REV. 149, 151-52 (1966) (noting differences in the economic background of the United States and England as reason for disparate approaches).

¹⁵⁴ It has not, however, prevented England from going further or moving faster than the United States in providing greater protection for debtors when the utility of bankruptcy as a collection device is not threatened by the reform. This is why it is a mistake to view the differences in discharge policy simply in terms of liberality or frugality. For instance, England abolished

If a similar firm linkage between bankruptcy and debt collection ever had been established in the United States, the history of discharge policy here might have been far different. But that linkage was never established, in part because the responsibility for enacting bankruptcy laws and collection laws was assigned to different governmental units: bankruptcy was the province of the federal government while the enactment of collection laws was left to the states.¹⁵⁵ This division of responsibilities between state and federal governments added a dimension never present in England to the conflict over reconciliation of debtor and creditor interests. During the nineteenth century the United States had four federal bankruptcy acts. State distrust of a powerful federal government was a significant factor in the prompt demise of the first three.¹⁵⁶

Virtually all state laws [regulating the debtor-creditor relationship] operated to the procedural, and often the substantive, disadvantage of out-of-state lenders. Moreover, the provisions of these laws were patchwork personified, ranging from the stern Blackstonian canon making a debtor liable with his "body, lands, and goods" to a variety of emendations, some humanitarian and some

gratuitous reaffirmations of discharge debts in 1849, more than a century before the U.S. Congress adopted an approach that still provides less effective protection to discharged debtors. See 11 U.S.C. § 524(c), (d) (Supp. V 1981); Boshkoff, *The Bankrupt's Moral Obligation to Pay His Discharged Debts: A Conflict Between Contract Theory and Bankruptcy Policy*, 47 IND. L.J. 36, 46-48 (1971). The English also provided for voluntary bankruptcy proceedings at an earlier date. See An Act to amend and consolidate the Law relating to Bankrupts, 12 & 13 Vict., ch. 106, § 93 (1849). The United States did not authorize voluntary petitions until 1867. See 14 Stat. 517, § 11 (1867). Finally, since 1883 English bankruptcy judges have been able to grant a discharge to the truly unfortunate debtor no matter how seriously he has misbehaved, although no such power is vested in American bankruptcy judges even today. Note that none of these changes diminishes the utility of bankruptcy as a collection device. The two features of American bankruptcy law which lessen its utility as a collection device, a liberal exemption policy and a limited discharge provision, do not play a significant role in the English process.

¹⁵⁵ Interestingly, in 1898 the lack of linkage between federal bankruptcy legislation and state collection laws was cited as a reason for *not* enacting permanent bankruptcy legislation by a United States Senator who believed that an integration of the two laws was desirable.

Bankruptcy laws are a part of the system of collection laws in foreign countries. They dovetail into and supplement the collection laws; hence their adaptability can be regulated intelligently; but with us the Federal Government has exclusive jurisdiction over the subject of bankruptcy laws, while the various States control the collection laws. The collection laws of this country . . . are as dissimilar as the topography of the States, and more so than their unevenly developed civil agencies.

No general bankruptcy law can supplement them, because of their lack of uniformity. No country that does not control the collection laws can successfully maintain bankruptcy laws. This is peculiarly true respecting this Government, on account of its unique relation to the States. It is impossible for any general bankruptcy bill to operate with that fairness and equality in this country that is necessary to its permanency.

31 CONG. REC., pt. 2, at 1849 (1898) (remarks of Sen. Crumpacker).

¹⁵⁶ M. KELLER, *AFFAIRS OF STATE* 172 (1977); see also S.W. DUNSCOMB, *supra* note 108, at 139-50. The classic study of the struggle for a national bankruptcy statute is C. WARREN, *supra* note 8. A shorter treatment of the subject is found in P. COLEMAN, *supra* note 146, at 16-30.

otherwise. The proposal that this disarray be replaced with a national bankruptcy act provoked what [Joseph Story, a strong champion of a national bankruptcy statute and later a Justice of the United States Supreme Court] would later call a "strange medley of the most opposite views."

There were many lines of cleavage in the controversy. Liberal construction of the Constitution collided with strict. British precedent traversed the American sense of experiment. Debtors and creditors were found on both sides of the status quo, depending on the laws of particular states. Some jurisdictions gave the real estate of planters and farmers almost complete immunity from execution. Others afforded a creditor the most summary methods of jailing his debtor on initial process and keeping him imprisoned virtually for life. Each set of advantages might be lost if a national bankruptcy law were enacted, and this lent a special interest to the question of the relationship between the bankruptcy powers given the federal government by the Constitution and the residual right of states to provide for insolvency, to free the person and property of debtors from oppressive claims, and to regulate process and procedure in their own courts¹⁵⁷

By 1898 it had become clear that an expanding national commerce required the enactment of a federal statute that uniformly regulated at least some aspects of the debtor-creditor relationship. Creditors were clamoring for a national bankruptcy act and were more willing than ever before to make concessions to obtain it. It was in this atmosphere that a new balance between debtor and creditor interests was struck.

The main debate in Congress centered on two issues. First, debtor interests desired only a voluntary act while creditors sought a statute permitting only involuntary petitions. In the end, a compromise was achieved and both types of proceedings were authorized.¹⁵⁸ Second, congressmen receptive to the creditor position apparently came to the conclusion that they had to break sharply with English tradition in fashioning an appropriate discharge rule.¹⁵⁹ If they did not, there was little

¹⁵⁷ G. DUNNE, *JUSTICE JOSEPH STORY AND THE RISE OF THE SUPREME COURT* 145-46 (1970).

¹⁵⁸ The compromise gave special protection to agrarian interests, which wanted only a voluntary statute. Even today a farmer may not be the subject of involuntary proceedings. 11 U.S.C. § 303(a) (Supp. V 1981).

¹⁵⁹ The congressional debates are curiously silent on this issue. There was no attempt to secure adoption of the English conditional discharge system. One can only conclude that the creditor forces had decided that this was a battle that could not be won. Even Jay Torrey, a St. Louis lawyer and architect of the pro-creditor version of the proposed new statute, see C. WARREN, *supra* note 8, at 134, came to the early conclusion that a new approach to discharge policy was necessary. In a speech delivered to the National Association of Credit Men in Kansas City during the summer of 1897, he indicated a willingness to make this concession to debtor interests:

A wise public policy justifies the discharge of honest insolvents; it does not justify

hope of securing sufficiently widespread support for a national statute. The creditor-consent provisions in the short-lived Bankruptcy Act of 1867 had been unpopular. Therefore, in the opening debate on the pro-creditor Torrey Bill, Senator Lindsay of Tennessee signaled a new approach to discharge policy:

In the course of the consideration of the subject, there has been more or less discussion as to whether discharges should be conditioned upon the payment by an estate of a certain percentage, or upon the consent of a certain proportion of the creditors. . . . The fact is that a discharge can be justified only upon the grounds of sound public policy; that is, the State is more interested in having an honest debtor relieved from obligations he can not meet, and given an opportunity to better support and educate his family and accumulate property upon which to pay taxes, than in having him held in financial bondage forever by individual creditors. The binding obligation of a contract ought not to be annulled except on this ground. . . . The true doctrine is that no dishonest debtor should receive a discharge, no matter what percentage his estate pays or what number of his creditors have been induced to assent; but, on the other hand, every honest debtor should be discharged, irrespective of the money value of his estate or the assent of his creditors.¹⁶⁰

Clearly, the division of responsibility between Congress and the states would not have led to adoption of a new discharge policy if all the senators and representatives had held pro-creditor views. But the dramatic westward expansion which occurred during the nineteenth century produced a sectionalism that eventually favored debtor interests. The most obvious evidence of a new regional attitude toward debt is found in the laws of many western states exempting homesteads and

the discharge of those who are dishonest. This public policy is not concerned with the value of the estate, but only with the honesty of the citizen who is to be benefited by the discharge. . . .

. . . [T]he public is not so much interested in having a citizen pay his debts as it is in having him provide for his dependents, keep[ing] them from becoming a public charge. . . . Under one of the former bankruptcy laws the payment of 50 per cent . . . was required in order to get a discharge. But it was found that it could not be justified, and hence the law was amended, and this requirement omitted from it. It would not work well in practice to say that a given debtor was entitled to a discharge because of the value of his estate, and that another of equal moral worth could not have a discharge because his estate had [sic] sold under unfavorable circumstances and the net result was not of the required amount. It is, therefore, not right nor feasible to grant a discharge upon any ground other than the honesty of the debtor applying for it.

PROCEEDINGS OF THE NATIONAL ASSOCIATION OF CREDIT MEN, S. EXEC. DOC. NO. 156, 55th Cong., 2d Sess. 9-10 (1898).

¹⁶⁰ 30 CONG. REC., pt. I, at 603 (1898).

other assets from forced sale to satisfy creditor claims. These laws were tangible evidence of a community sentiment that there were certain matters more important than the repayment of debt.¹⁶¹

This attitude toward the repayment of debt was well recognized by those who sought a new bankruptcy law. State-created exemptions were also recognized in federal bankruptcy proceedings.¹⁶² Indeed, during congressional debates over the new bankruptcy legislation, not even the most ardent champion of creditor interests suggested a continuation of the conditional discharge rule found in former bankruptcy statutes. The abandonment of this important principle, which had governed debtor-creditor relations in the opening years of the Republic, was complete and, strikingly, without much comment. Creditor interests wanted a national law that would survive for more than a few years, and they wanted a statute that provided for involuntary bankruptcy proceedings. To gain these objectives they were willing to yield to debtors the right to institute voluntary proceedings and to abandon the conditional discharge rules; indeed, they abandoned the conditional discharge principle without the slightest expression of regret.

The fragmentation of legislative responsibility between the na-

¹⁶¹ Two centuries before, the then rapidly expanding colonies on the eastern seaboard had reacted against imprisonment for debt on pragmatic grounds:

The inability of the legal order to distinguish between the patently dishonest and the merely unfortunate soon forced legislatures in the New World as well as the Old to re-evaluate the concept of imprisonment for debt. It became increasingly evident that the institution was not working effectively. Though the threat of incarceration must have kept some borrowers honest, imprisonment rarely pried loose concealed property and only sometimes prompted friends or relatives to pay off the debt. Since most defaulters were indigent, imprisonment reduced the ability to repay by piling court and jail fees on top of the debt, cutting them off from gainful employment, and by leaving their dependents to fend for themselves.

The debtors' prison provided no practical benefits to the general public either. Though it did not necessarily cost anything to operate, it deprived the community of valuable labor, something that colonial society could ill afford to lose. Imprisonment also thinned the ranks of the militia, made it more difficult to keep fortifications in good repair, and weakened colonial defense.

Moreover, the system often burdened the community with the cost of caring for the debtor's dependents, and if or when the defaulter returned home he could be broken in health no less than in spirit. Lacking all but the barest necessities for survival, some never lifted themselves out of their poverty and lived out their wretched lives as wards of the public or subsisted on private charity. Thus imprisonment sometimes served the community as badly as it served creditors.

P. COLEMAN, *supra* note 146, at 250.

The western colonists of the nineteenth century were equally pragmatic in outlook. The exemption laws, which originated in Texas, were "specifically meant to encourage immigration. [They] sought, indirectly, through the office of security, to mobilize labor and capital toward the prime job of the times: building population and enriching the land," L. FRIEDMAN, *A HISTORY OF AMERICAN LAW* 215 (1973), and permitted those who moved west to "retain . . . the feeling of freedom and sense of independence which was deemed necessary to the continued existence of democratic institutions." TEX. CONST. ANN. art. 16, § 50 (Vernon 1955).

¹⁶² Bankruptcy Act of 1898, ch. 541, § 6, 30 Stat. 544, 548 (codified as amended at 11 U.S.C. § 522 (Supp. V 1981)).

tional and state governments strengthened the hand of debtor interests in one other respect: It deferred for almost 100 years the moment when our society had to strike a permanent balance between debtor and creditor interests. During the nineteenth century, debtor-creditor law was freewheeling: Each state chose the balance it thought appropriate for local needs, and from time to time the federal government intervened with temporary bankruptcy legislation. The United States Supreme Court facilitated seven decades of this experimentation by ruling in 1827 that state insolvency laws remained in effect during periods when there was no federal bankruptcy legislation.¹⁶³ If the Court had invalidated state laws during periods of congressional inactivity, the demand for federal legislation would have been much stronger. Moreover, a statute enacted in the wake of such a decision—prior to the enactment of state exemption laws; prior to the development of a powerful alliance between debtors and western sectional interests; and prior to the full development of adequate remedies for the collection of judgments at the state level—most likely would have continued to rely on conditional discharge rules. When bankruptcy proceedings were first instituted in England, collection remedies were woefully inadequate. The proceedings themselves were viewed as a response to the collection problem.¹⁶⁴ By the time that bankruptcy proceedings became a permanent part of our federal statutory law, however, the creditor's arsenal of collection devices was fully developed.¹⁶⁵ Thus, Congress was free to consider another objective for bankruptcy proceedings—the return of the honest debtor to productive society, free of the continuing control of both the bankruptcy court and creditors. Earlier in the nineteenth century, this country might well not have been ready to ignore the possibility of using bankruptcy as a collection device.

Americans during the nineteenth century participated in a turbulent period of economic growth and territorial expansion. One by-product of the dramatic westward movement was the creation of an electorate which, eventually, would be able to insist upon a new direction in discharge policy. The complex relationship between our national and local governments resulted in a delay of almost 100 years before a permanent bargain could be struck between debtor and creditor interests.

¹⁶³ *Ogden v. Saunders*, 25 U.S. (12 Wheat.) 213 (1827).

¹⁶⁴ See *supra* text accompanying note 147.

¹⁶⁵ See generally W.E. NELSON, *AMERICANIZATION OF THE COMMON LAW* 152 (1975); Riesenfeld, *Collection of Money Judgments in American Law—A Historical Inventory and a Prospectus*, 42 IOWA L. REV. 155 (1957). Similarly, it has been suggested that the abolition of imprisonment for debt became possible as more creditors' remedies became available. See G.P. Bauer, *The Movement Against Imprisonment for Debt in the United States 197-201* (1935) (unpublished doctoral thesis available from Harvard University Archives).

When the moment of decision finally arrived, creditor interests did not have enough votes to secure all that they desired. In a very pragmatic fashion, they chose not to press for a conditional discharge feature in the new bankruptcy statute. For them, a permanent bill authorizing involuntary proceedings was the prime objective. And so, almost by default, the link between payments to creditors and the debtor's entitlement to a discharge ceased to exist in this country.

V. THE FUTURE OF DISCHARGE POLICY IN THE UNITED STATES

Proposals for changes in the bankruptcy process are presently being circulated in both England and the United States. These proposals do not arise from a common dissatisfaction with the way in which the systems are functioning. Indeed, they are rooted in entirely different concerns. In the United States, creditors are mounting a frontal assault on the substantive law of discharge. They seek a return to the nineteenth century model of the debtor-creditor relationship. Abroad, there is a movement to restructure the administrative framework within which bankruptcy proceedings are conducted. Because the English proposals are not yet fully developed,¹⁶⁶ this part of the Article will deal only with suggested changes in American discharge policy.

The compromise effected by the Bankruptcy Act of 1898¹⁶⁷ was not a lasting one. Current legislation before Congress represents the third time in this century that creditors have made a serious attempt to substitute rules of condition for rules of limitation as the foundation of American discharge policy. The first attempt to accomplish this occurred in 1932. At that time, creditors urged that the discharge of the debtor be suspended for a period of two years unless there were suffi-

¹⁶⁶ In 1977, the then-incumbent Labor Government established an Insolvency Law Review Committee, headed by Mr. (now Sir) Kenneth Cork. The Cork committee was given a broad charge to review all the laws relating to insolvency and bankruptcy in England and Wales and to make recommendations for appropriate changes. The committee's report recommended that a multi-track insolvency process replace the present personal bankruptcy proceeding. Under the Cork proposal most debtors would not have to submit to a public examination and would not be subject to the control of the Official Receiver. The current rigorous procedure would be reserved "for the comparatively few serious cases." CORK, FINAL REPORT, *supra* note 28, ¶ 554. See generally *id.* ¶¶ 272-348, 553, 599, 610-614 & 715; CORK, INTERIM REPORT, *supra* note 39, at 3, 5-7.

The current Conservative Government, which came into power after the Cork Committee began its deliberations, has expressed its own ideas regarding bankruptcy law reform. In a Consultative Document released the same day as the Cork Interim Report, the Thatcher Government viewed the bankruptcy system from a fiscal perspective and proposed to transfer much of the responsibility for funding the administrative costs of bankruptcy from the public to the private sector. It suggested that the Official Receiver in all cases be replaced by a private receiver, appointed by the court upon the nomination of the debtor in a voluntary case and the petitioning creditor[s] in an involuntary proceeding. The petitioner[s] would be obligated to underwrite the cost of this private official. See TRADE BANKRUPTCY, *supra* note 39, at 7-8.

¹⁶⁷ See *supra* notes 158-60 and accompanying text.

cient assets to pay creditors fifty cents on the dollar or the debtor could show that bankruptcy was caused by circumstances for which the debtor could not justly be held responsible. During this period of suspension the debtor would be obligated to turn over to the bankruptcy trustee all nonexempt property and future income beyond that needed for necessary business and living expenses.¹⁶⁸ This legislation provoked some emotional responses¹⁶⁹ and was never reported out of committee. In 1938, however, Congress did provide an effective¹⁷⁰ vehicle for allocating the debtor's future income among creditors when it authorized the institution of proceedings under a new Chapter XIII. Wage earners were permitted to propose composition and extension plans¹⁷¹ that, prior to court approval, had to be accepted by a majority in number and amount of all affected unsecured creditors.¹⁷²

The enactment of Chapter XIII marked the reintroduction of rules of condition into American bankruptcy legislation. But the power given to creditors by this congressional action was in no sense comparable to the power conferred by the creditor-consent provisions of previous American bankruptcy statutes or by British discharge practice. Chapter XIII was entirely voluntary,¹⁷³ and debtors were still entitled to use

¹⁶⁸ *Uniform System of Bankruptcy: Joint Hearings On S. 3866 Before Subcomms. of House and Senate Comms. on the Judiciary*, 72nd Cong., 1st Sess. 100-01 (1932).

¹⁶⁹ It is shocking that an American Congress could ever foist upon a liberty-loving people such a document as has been here drafted. Although I have not read all the bankruptcy laws of the country, I have been reading them for about 19 years and have written about them, and still know very little. I would like for anyone to show to this committee that in any country having a constitutional protection of life, liberty, and the pursuit of happiness which we have, any bankruptcy act that contains the stringent provisions of this proposed amendment, something that is absolutely out of step with our conception of liberty.

We seem to have gone so far in this country that we are apparently willing to foist upon the public an act that absolutely destroys all exemptions guaranteed under the constitutions of the several States, and that makes a free-born American citizen come into court and stultify himself by telling what money he needs for clothing, food and shelter for his family. How far have we gone in this country when Congress will even consider such a proposition as that? I can well imagine the founders of this Republic, Jefferson and Washington and others, turning over in their graves to think that their fellow-citizens should be required to come into court at specific intervals and report to referees whose salaries are fixed by Washington, in the presence of the representatives of the man who fixes the salaries, with the great power of this Government against them. It is a shocking thing to think that an American citizen is required to come into court and explain to the court how much he needs for food and shelter and clothing for his family.

Id. at 546-47 (statement of M. Feibelman).

¹⁷⁰ A similar proceeding had been authorized five years earlier but it was not effective because it failed to give the court jurisdiction over the debtor's wages or provide for a discharge. See Woodbridge, *Wage Earners' Plans in the Federal Courts*, 26 MINN. L. REV. 775, 775-76 (1942).

¹⁷¹ Bankruptcy Act of 1898, ch. 541, 30 Stat. 544, amended by Act of June 22, 1938, ch. 575, § 622, 52 Stat. 883, 931 (repealed 1979).

¹⁷² Act of June 22, 1938, ch. 575, § 652(1), 52 Stat. 883, 934.

¹⁷³ *Id.* § 622, 52 Stat. 883, 929.

traditional liquidation bankruptcy with its rules of limitation.

Predictably, the creditors' next move was an attempt to obtain mandatory Chapter XIII proceedings. In 1965, legislation introduced in the House called for a dismissal of a petition in liquidation bankruptcy if the debtor failed to show that adequate relief could not be obtained through the use of Chapter XIII.¹⁷⁴ The Senate bill¹⁷⁵ was even more favorable to creditors, giving them a right to force conversion to Chapter XIII if the court found such action to be "feasible and desirable, and for the best interests of the creditors." But once again, enough votes could not be mustered to alter the course of American discharge policy.¹⁷⁶

Shortly thereafter, the Bankruptcy Commission began its comprehensive review of American bankruptcy legislation. And once more, the desirability of relying solely on rules of limitation was affirmed:

Dishonest resort to the bankruptcy process and dishonest conduct and anticipation of its use, by debtor or creditor, should be deterred and sanctioned directly by denial of relief and by criminal prosecution and conviction. Punishing debtor dishonesty and incompetence by such disabilities as "conditional discharge" or "undischarged status," imposed on ex-bankrupts under the laws of Canada, England, and other nations, is not appropriate in this country. These sanctions have the effect of placing legal restraints on the debtor's renewed participation in the open credit economy. They are also incompatible with the fundamental characteristic of the open credit economy that participation is determined by economic considerations, not legal controls. Thus they are also incompatible with the fresh start policy that aims to support the goals of the open credit economy.¹⁷⁷

Curiously, the Bankruptcy Commission was not entirely faithful to this statement. Tucked away in section 4-506(a)(8) of its proposed statute was an exception from discharge for "any educational debt if the first payment of any installment thereof was due on a date less than five years prior to the date of the petition and if its payment from future income or other wealth will not impose an undue hardship on the debtor and his dependents."¹⁷⁸ In a comment, the Commission provided some guidelines for determining the dischargeability of such a debt:

In order to determine whether nondischargeability of the debt will

¹⁷⁴ H.R. 292, 89th Cong., 1st Sess. (1965).

¹⁷⁵ S. 613, 89th Cong., 1st Sess. (1965).

¹⁷⁶ For a good discussion of these proposals, see Comment, *supra* note 10, at 541-43.

¹⁷⁷ BANKRUPTCY REPORT, *supra* note 10, pt. I, at 83.

¹⁷⁸ *Id.*, pt. II, at 136.

impose an "undue hardship" on the debtor, the rate and amount of his future resources should be estimated reasonably in terms of ability to obtain, retain, and continue employment and the rate of pay that can be expected. Any unearned income or other wealth which the debtor can be expected to receive should also be taken into account. The total amount of income, its reliability, and the periodicity of its receipt should be adequate to maintain the debtor and his dependents, at a minimal standard of living within their management capability, as well as to pay the educational debt.¹⁷⁹

In 1976, Congress, using somewhat different language to accomplish the same result, provided special nondischargeable status for certain educational debts.¹⁸⁰ Putting aside the question whether educational creditors should receive any special treatment,¹⁸¹ we can see that the true significance of the Commission's recommendation and Congress's response is found in the technique adopted to reconcile debtor and creditor interests. For the first time in seventy-eight years, eligibility for discharge in liquidation bankruptcy was linked with ability to pay.

We should also note one other situation in which the bankruptcy

¹⁷⁹ *Id.* at 140-41.

¹⁸⁰ 20 U.S.C. § 1087-3 (1976). Although this section was repealed in 1979, the special treatment for educational loans was carried forward, in a slightly different version, into the discharge provisions of the Bankruptcy Reform Act of 1978. 11 U.S.C. § 523(a)(8) (Supp. V 1981). See generally Ahart, *Discharging Student Loans in Bankruptcy*, 52 AM. BANKR. L.J. 201 (1978); Kosel, *Running the Gauntlet of "Undue Hardship"—The Discharge of Student Loans in Bankruptcy*, 11 GOLDEN GATE U.L. REV. 457 (1981); Note, *Student Loan Bankruptcies*, 1978 WASH. U.L.Q. 593. The undue hardship rule is not exactly the same as the English conditional discharge because the debtor is not obligated to make any specific payment. The debt is simply not discharged and the creditor is permitted to employ traditional state collection devices. The rule does, however, require a determination of the debtor's financial condition.

¹⁸¹ The justification offered by the Bankruptcy Commission for its special treatment of student loans seems rather weak.

A separate clause to provide for a limited nondischargeability of educational loan debts is desirable for two kinds of reasons. First, a loan or other credit extended to finance higher education that enables a person to earn substantially greater income over his working life should not as a matter of policy be dischargeable before he has demonstrated that for any reason he is unable to earn sufficient income to maintain himself and his dependents and to repay the educational debt. Second, such a policy cannot be appropriately carried out under any other nondischargeability provision. . . . [Dischargeability provisions currently in force] neither provide for nondischargeability of debts incurred honestly which the debtor subsequently decides not to pay nor distinguish between persons scheduling educational debts who, under the general "fresh start" policy of the proposed Act, should and those who should not be enabled to discharge them.

BANKRUPTCY REPORT, *supra* note 10, pt. II, at 140. A similar argument can be made to support special treatment for other loans which enhance the quality of life. Indeed, extensions of credit which help sustain life itself, for example, credit for expenses related to medical and hospital care and food and clothing bills, would seem to present even stronger claims upon the debtor's future income. But because the financial interests of the federal government were directly affected by defaults on student loans, this particular recommendation of the Bankruptcy Commission attracted special attention.

court is now called upon to examine debtors' future earning power. The new Bankruptcy Reform Act continues to provide many debtors with the option they have had since 1938: They may choose liquidation bankruptcy or may propose a composition with creditors under a revised and retitled Chapter 13 (Adjustment of Debts of an Individual With Regular Income).¹⁸² As Congress considered this new Chapter 13, the question whether it should be mandatory was discussed once again:

As under current law, Chapter 13 is completely voluntary. This Committee firmly rejected the idea of mandatory or involuntary Chapter XIII in the 90th Congress. The Thirteenth Amendment prohibits involuntary servitude. Though it has never been tested in the wage earner plan context, it has been suggested that a mandatory Chapter 13, by forcing an individual to work for creditors, would violate this prohibition. On policy grounds, it would be unwise to allow creditors to force a debtor into a repayment plan. An unwilling debtor is less likely to retain his job or to cooperate in the repayment plan, and more often than not, the plan would be preordained to fail.¹⁸³

Although Congress rejected the view that debtors should be coerced into entering Chapter 13, it tried to make its use so attractive that more debtors would wish to take advantage of this type of proceeding. One consequent change was the elimination of any requirement that creditors approve the plan.¹⁸⁴ At the same time, Congress recognized that some substitute form of debtor control was necessary. Creditors now are protected against abuse of Chapter 13 by the requirement (1) that they receive at least as much as they would in a liquidation bankruptcy¹⁸⁵ and (2) that the court find that the plan has been proposed in "good faith."¹⁸⁶ Since most creditors would receive nothing in a Chapter 7 (liquidation bankruptcy) proceeding, the main burden of preventing exploitation of Chapter 13 falls on the concept of good faith. Courts are now struggling with the question whether a plan that proposes no payments to unsecured creditors can still be in good faith.¹⁸⁷ More importantly, those courts which find that some payment is required must

¹⁸² 11 U.S.C. §§ 1301-1330 (Supp. V 1981).

¹⁸³ H.R. REP. NO. 595, *supra* note 10, at 120. For a recent examination of the objections to mandatory Chapter 13 proceedings, see Eisenberg, *Bankruptcy Law in Perspective*, 28 U.C.L.A. L. REV. 953, 986-91 (1981).

¹⁸⁴ H.R. REP. NO. 595, *supra* note 10, at 123.

¹⁸⁵ 11 U.S.C. § 1325(a)(4) (Supp. V 1981).

¹⁸⁶ *Id.* § 1325(a)(3).

¹⁸⁷ For an argument that the term "good faith" has nothing to do with the level of payment, see Cyr, *The Chapter 13 "Good Faith" Tempest: Analysis and Proposal for Change*, 55 AM. BANKR. L.J. 271 (1981).

still fix its appropriate level. What the debtor can afford to pay out of future income is clearly the main factor to be considered in establishing this level.¹⁸⁸

The most recent development of interest is the introduction in both the House and Senate of legislation which would expand dramatically the use of rules of condition to determine eligibility for discharge. H.R. 4786 states simply: "an individual may be a debtor under Chapter 7 of this title *only if* such individual cannot pay a reasonable portion of his debts out of anticipated future income."¹⁸⁹ If this bill passes, the debtor who fails to meet this standard will be left to choose between the tender mercies of state collection law and use of Chapter 13. If she selects the latter option she must give her creditors whatever is necessary out of her future income to obtain judicial approval of the composition plan.¹⁹⁰ S. 2000 is more elaborate¹⁹¹ but provides the debtor with essentially the same unpleasant choices.

Both bills seek to prevent alleged abuses¹⁹² of the bankruptcy pro-

¹⁸⁸ The literature on this topic is substantial. In addition to Cyr, *supra* note 187, see Hughes, *Chapter 13's Potential for Abuse*, 58 N.C.L. REV. 831 (1980); Note, *Good Faith, Zero Plans, and the Purposes of Bankruptcy Code Chapter 13: A Legislative Solution to the Controversy*, 61 B.U.L. REV. 773 (1981); Note, *Payments to Unsecured Creditors Under Chapter 13 of the Bankruptcy Reform Act of 1978*, 57 IND. L.J. 189 (1982); Note, *"Good Faith" and Confirmation of Chapter 13 Composition Plans: Analysis and a Proposal*, 65 MINN. L. REV. 659 (1981); Note, *Abusing Chapter 13 of the Bankruptcy Code: The Problem of Nonrepayment*, 55 N.Y.U. L. REV. 941 (1980); Note, *Filing for Personal Bankruptcy: Adoption of a "Bona Fide Effort" Test Under Chapter 13*, 14 U. MICH. J.L. REF. 321 (1981).

¹⁸⁹ H.R. 4786, 97th Cong., 1st Sess. § 2 (1981) [hereinafter cited as House bill].

¹⁹⁰ Both the House bill and a counterpart bill before the Senate also propose language that would impose a more demanding payment standard in Chapter 13 proceedings. See *id.* § 19(1), (4); S. 2000, 97th Cong., 1st Sess., § 19(a), (b) (1981) [hereinafter cited as Senate bill].

¹⁹¹ The Senate bill, *supra* note 190, § 3, would amend 11 U.S.C. § 109 (Supp. V 1981) by inserting the following language:

(1) Subject to the provisions of paragraph (2) of this subsection, an individual may not be a debtor under chapter 7 of this title if such individual can pay a reasonable portion of his debts out of anticipated future income. For the purposes of this paragraph, the term—

(a) "reasonable portion of debts" means a substantial percentage of the total outstanding debt reflected upon the schedule of liabilities filed pursuant to section 521(a)(1), excluding debts secured by a first mortgage or deed of trust on the debtor's principal residence;

(b) "anticipated future income" means such income, if any, that the debtor has a reasonable expectation of receiving, either from sources which—

(i) are providing actual income at the time of the filing of the petition, or
(ii) will provide income commencing upon a date certain within twelve months following the filing of the petitions, and which is not needed by the debtor for the support of himself and his dependents.

(2) The provisions of this section shall not apply in any case where the court finds that its application would impose undue hardship upon the debtor and the debtor's dependents.

¹⁹² See generally *Bankruptcy Reform Act of 1978: Hearings Before the Subcomm. on Courts*

cess. It is probably too soon, though, to reach a firm conclusion as to whether or not substantial abuse exists because the Bankruptcy Reform Act has been in effect for only three years. But anyone familiar with the discharge process in England can reach some firm conclusions concerning the practical consequences of establishing a link between ability to pay and debtor rehabilitation.

It is absolutely clear that rules of condition which do not use a fixed level of payment to determine eligibility for discharge inevitably cause the judge to become an arbiter of the debtor's lifestyle. Application of the undue hardship rule requires active intervention in the debtor's affairs and a judgmental attitude toward bankruptcy, an attitude that is traditional in England, but one which many American bankruptcy judges may find difficult to assume. Some evidence of this may already be found in decisions interpreting the "undue hardship" requirement of section 523(a)(8)(B) and the "good faith" requirement of section 1325(a)(3) of the Bankruptcy Reform Act of 1978.¹⁹³ Furthermore, findings of "undue hardship," "good faith," "reasonable portion of debts," "needed by the debtor for support of himself and his dependents," and the like will not lend themselves to systematic classification.¹⁹⁴ There are so many variations in the human condition that

of the Senate Comm. on the Judiciary, 97th Cong., 1st Sess. (1981) [hereinafter cited as *Senate Hearings on BRA of 1978*].

¹⁹³ See, e.g., *In re De Angelis*, [1978-81 Transfer Binder] BANKR. L. REP. (CCH) ¶ 67,082 (Bankr. E.D. Pa. Mar. 20, 1979) (applying 20 U.S.C. § 1087-3 (1976) (current version at 11 U.S.C. § 523(a)(8) (Supp. V. 1981)), the court concluded that the debtor was occupying premises which were too expensive). Courts have considered factors other than ability to pay in determining whether undue hardship exists. See Kosel, *supra* note 180, at 466-76. It is likely that ability to pay eventually will become the predominant test.

¹⁹⁴ The proposed Bankruptcy Amendments Act of 1981, S. 863, 97th Cong., 1st Sess., § 128(b), reprinted in *Senate Hearings on BRA of 1978*, *supra* note 192, at 319, 407, purported to provide some assistance to courts struggling to define good faith. The new statute would have added a requirement that the plan also represent the debtor's bona fide effort. While the legislative history made it clear that the zero payment plan was not to be the norm, it was not particularly helpful in providing courts with guidance as to the appropriate level of payment. Each debtor's situation is so idiosyncratic that a payment of 10% in one case may be adequate and a payment of 70% in another case may be unsatisfactory. The report of the Senate Committee on the Judiciary, S. REP. NO. 150, 97th Cong., 1st Sess. 18-19 (1981) recognized this situation:

"The bona-fide effort" requirement is responsive to the widespread concern among creditors and judges alike that the provisions of chapter 13 as enacted inadvertently permitted plans to be confirmed that proposed little or no payments to unsecured creditors. This is contrary to the historical spirit and intent of chapter 13 which was to afford the debtor the protection of the bankruptcy court while the debtor worked out a plan to repay his creditors over a period of years out of his future earnings. Thus, chapter 13 is a remedy for the individual with severe cash-flow problems while chapter 7 would be available for the debtor who simply has no present or foreseeable prospects of paying his debts at all

The "bona-fide effort" test is intended to require that the plan proposed by the debtor is a real effort and not a half-hearted effort by the debtor to repay his creditors. It means that the debtor should forego luxuries during the term of the plan.

bankruptcy judges will be required to make highly individualized decisions providing little or no guidance for future use. One person's luxury may be another person's necessity. The condition of debtors is so unique that the development of meaningful budgeting standards in this area is almost impossible. The English have been operating a conditional discharge system for almost one hundred years and they have yet to develop one single rule at the appellate level that can be used to predict the level of payment required in any particular case.¹⁹⁵ Discharge rulings, in fact, are almost never appealed¹⁹⁶ and the English system places heavy reliance on the bankruptcy judge's determination of what can humanely be required of any particular debtor. More than five years of experience with the undue hardship rule for student loans

For most debtors some sacrifice and adjustments to the debtor's standard of living will be required. There should be no such expenses as the purchase of new cars or for that matter continuing to make payments on a nearly new car at the expense of unsecured creditors under the plan. The courts should look at all the circumstances of the debtor and, in some cases, require the debtor to pursue a more modest lifestyle.

This is not to say that any court should require undue financial hardship of the debtor during the plan. No arbitrary repayment levels should be required by judges, neither should trustees be permitted to require a certain level of payments in return for not opposing confirmation.

There must be room in chapter 13 for the debtor on welfare or old-age assistance who can only pay a nominal amount. There should not be room for the single-payment plan or the new college or the professional school graduate seeking a new start at the expense of his creditors and future generations of students. In some cases courts should require the debtor to repay his unsecured creditors in full, but that should not necessarily become the norm as it was in many jurisdictions under the Bankruptcy Act.

In short, chapter 13 must be a legitimate alternative for the debtor in financial difficulty who honestly wants to pay his debts. If this is the case, then the debtor's own creditors will encourage the debtor to seek the alternative and the maximum repayment to all creditors will be achieved.

What is notable in this statement is not how much it tells us but rather how little information it supplies. Although this amendment is designed to address one of the most controversial bankruptcy issues of recent times, all the subcommittee can do is offer one firm rule: zero payment plans are not to be the norm in all Chapter 13 cases. After that, the statement becomes very vague. The report states that a "real," not "half-hearted," effort is required. Most (but not all) debtors must make "some sacrifice and adjustment to [their] standards of living." In some cases "a more modest life style" is required but "this is not to say that any court should require undue financial hardship of the debtor during the plan." One can hardly blame bankruptcy judges if they are dizzy and a bit confused after digesting this morsel of legislative history.

S. 2000 also imposes a more rigorous repayment standard in Chapter 13. The explanation of the standard is shorter than the one provided in S. 863 and equally unhelpful. See S. REP. NO. 446, 97th Cong., 2d Sess. 45-46 (1982).

¹⁹⁵ The few reported opinions deal with the appropriateness of a suspended discharge. See, e.g., *Re Smith*, [1947] 1 All E.R. 769. Note further that in Mr. Registrar Hunt's decision, *supra* text accompanying note 112, there is no explanation of how the amount of payment or the period of suspension was determined.

¹⁹⁶ I was informed that one bankruptcy official, who made, on the average, 50 discharge decisions a month, had been subject to only two appeals from a discharge ruling in 14 years. Moreover, neither appeal concerned the propriety of a condition of payment or a period of suspension.

suggest that American appellate courts will show similar deference for the trial court's decision.¹⁹⁷

Few American judges will welcome such a responsibility:

It is regrettable that Congress shed so inadequate a spotlight on the exculpating phrase "undue hardship". What can be gleaned is that the hardship is to be found in the exceptional case and must be based on something more than present inability to pay. It is also regrettable that so much is therefore left to the individual view of each judge who, after all, brings a sum of who and what he was, what he has become, and what he sees through his own eyes to this basically disagreeable task.¹⁹⁸

Why should the determination of undue hardship be a "basically disagreeable task"? At first glance it appears to be no more difficult than the application of any other legal rule providing the judge with only general guidance as to its content. We would not so characterize the determination of whether a contract is unconscionable,¹⁹⁹ whether a creditor had reasonable cause to believe that a debtor was insolvent,²⁰⁰ or whether a creditor reasonably relied²⁰¹ on a false financial statement,

¹⁹⁷ No circuit court has reversed a lower court's finding that repayment would constitute undue hardship. *But see In re Andrews*, 661 F.2d 702 (8th Cir. 1981) (court remanded the case, holding that the trial court had improperly failed to consider certain evidence, but carefully avoided expressing any opinion as to whether undue hardship actually existed).

Bankruptcy Rule 810 requires the reviewing authority to accept the bankruptcy court's finding of facts unless they are "clearly erroneous." 11 U.S.C. app.—Bankr. R. 810 (1976). Findings of law, however, are not entitled to such deference and may be set aside if the reviewing authority disagrees with the lower court's conclusion. *In re Meade Land & Dev. Co.*, 527 F.2d 280, 282-83 (3d Cir. 1975) (appeal of bankruptcy court's award of legal fees to counsel for the receiver and trustee of the bankrupt). The determination of whether the payment of an educational loan imposes an undue hardship may be classified as either a question of law or as a mixed question of law and fact. In the latter instance there is disagreement among the circuits as to the appropriate standard of review. The Second and Fifth Circuits adhere to the position that such determinations are not subject to the clearly erroneous standard. *In re Hygrade Envelope Corp.*, 366 F.2d 584, 588-89 (2d Cir. 1966); *Mayo v. Pioneer Bank and Trust Co.*, 297 F.2d 392 (5th Cir. 1961). *Contra Snider v. England*, 374 F.2d 717, 720 (9th Cir. 1967). See also 9 C. WRIGHT & A. MILLER, *FEDERAL PRACTICE AND PROCEDURE* § 2589 (1971); Weiner, *The Civil Nonjury Trial and the Law-Fact Distinction*, 55 CALIF. L. REV. 1020, 1042-43 (1967). In time, courts may hesitate to overturn lower court dispositions of the undue hardship issue no matter how they are styled. Today, there are some basic unresolved questions as to the meaning of the term. For instance, should the court consider the proportion of educational and noneducational debts? Is saving to be permitted? These are questions to which there should be a uniform response within the circuits and, one hopes, across the country. Unfortunately, appellate review of exactly how much a debtor can afford to pay her creditors following an initial nonarbitrary determination by the bankruptcy judge is hard to justify. Each case will be too idiosyncratic to have precedential value and judges will eventually realize that active appellate intervention is not an appropriate use of judicial resources. For a contrary view advocating free appellate review of such determinations, see *id.* at 1032-35.

¹⁹⁸ *New York State Higher Educ. Serv. Corp. v. White*, 6 Bankr. 26, 29 (Bankr. S.D.N.Y. 1980) (citations omitted).

¹⁹⁹ U.C.C. § 2-302 (1978).

²⁰⁰ 11 U.S.C. § 547(b)(4)(B)(ii) (Supp. V 1981).

²⁰¹ *Id.* § 523(a)(2)(B)(iii).

even though these standards are as vague as "undue hardship." Such determinations may be difficult; they are not disagreeable. It can be argued, however, that finding undue hardship is a disagreeable task because it requires the court to pass judgment, in a very personal fashion, on the debtor's future conduct. The judge does not simply determine whether past conduct satisfies a legal standard, but instead, becomes an architect of the debtor's future. When we also recognize that the court is passing judgment on the debtor's lifestyle, the controversial and often disagreeable nature of the task is easily seen. It is the intrusiveness of the decision that is so significant. The judge's difficulties are compounded by the fact that there is no general consensus on how we ought to live or eat or allocate our resources;²⁰² the judge is being asked to participate in planning the debtor's future without the guidance of any generally accepted principles of law. The paternalism implicit in such a process is extraordinary.

Consider, for example, the debtor's expenditure for housing. It will ordinarily be a substantial budget item. If savings can be achieved, creditors may benefit. Should the court tell the debtor to occupy more modest accommodations? Several courts have already responded in the affirmative. One case involved a debtor who preferred to live in a certain neighborhood and incurred larger rental payments than normal for a person of her income level. The court refused to consider the excess in determining whether there was undue hardship.²⁰³ The message was clear: her lifestyle must change. A second court delivered a more direct message when the issue was whether the debtors had proposed to pay creditors a sufficient amount under a Chapter 13 plan.²⁰⁴ No payment was provided for unsecured creditors. The judge observed that the debtors were occupying both apartments in a two-family house. If they rented out the upper apartment they could increase their cash flow by approximately \$310 per month; however, this would require five people to share three bedrooms in the first floor apartment. The judge then found a lack of good faith and denied confirmation of the plan. The debtors were given two weeks to submit a new plan in which payments were increased by \$310 per month.²⁰⁵

²⁰² Congress, for example, cannot even agree on a comprehensive expenditure budget for families at the poverty level. Food expenditures necessary to maintain scientifically established nutrition standards are the only item on which there is a consensus. See U.S. DEPT. OF HEALTH, EDUCATION, AND WELFARE, *THE MEASURE OF POVERTY* 21-24 (1976). Even this apparent consensus is misleading, however, because there is some disagreement over what the proper nutrition standard should be.

²⁰³ *In re De Angelis* [1978-81 Transfer Binder] BANKR. L. REP. (CCH) ¶ 67,082 (Bankr. E.D. Pa. Mar. 20, 1979).

²⁰⁴ *In re Manning*, 5 Bankr. 1231 (Bankr. W.D.N.Y. 1980).

²⁰⁵ Other housing-expense cases are *In re Brown*, 18 Bankr. 219, 224 (Bankr. D. Kan.

If creditors have the opportunity to ask for a modification of the debtor's lifestyle, it appears clear that they will use it. A paraplegic may have nothing to fear,²⁰⁶ but most debtors can expect many demands to change their living habits. After housing, the automobile is the most likely candidate for the judicial scalpel.²⁰⁷ But we all make numerous budgetary decisions each week and it is hard to imagine many which can not be challenged. Is dog food for the family pet a necessity?²⁰⁸ What are we to think of telephone service,²⁰⁹ legal representation,²¹⁰ life insurance,²¹¹ reading material,²¹² private education,²¹³ clothing,²¹⁴ charitable contributions,²¹⁵ psychotherapy,²¹⁶ a desire to as-

1982) (monthly rent of \$650 is excessive); *In re Packer*, 9 Bankr. 884, 887 (Bankr. D. Mass. 1981) (rent of \$330 per month is excessive in light of fact that debtor knew his debt would come due).

²⁰⁶ Mr. Butler. I am concerned and interested in your thought. You do mention the undue hardship exception. Payment of indebtedness is always a hardship; at least that has always been my experience. What is an undue hardship in your thought with reference to a student loan?

Mr. Erlenborn. This is something decided case by case. It is very difficult to spell out in the statute.

Mr. Butler. Do you have any statutory suggestions?

Mr. Erlenborn. I don't have any statutory suggestions. If after graduating from school, an individual becomes a paraplegic and earning capacity was impaired, there might be a finding of hardship.

BANKRUPTCY ACT REVISION, *supra* note 9, at 1092 (emphasis added).

²⁰⁷ See, e.g., *In re Wegfehr*, 10 Bankr. 826, 831 (Bankr. N.D. Ohio 1981) (court allowed discharge, in part because debtor had no "excess" expenditures such as car payments); *In re Packer*, 9 Bankr. 884, 887 (Bankr. D. Mass. 1981) (car not necessary because debtor lives near mass transit); *In re Rossotto*, 10 Bankr. 378, 380 (Bankr. W.D.N.Y. 1981) (debtor's auto-related expenditures not necessary to maintain him at reasonable standard of living); *Perkins v. Vermont Student Assist. Corp.*, 11 Bankr. 160, 161 (Bankr. D. Vt. 1980) (car held too expensive); *In re Ewell*, 1 Bankr. 311, 313 (Bankr. D. Vt. 1979) (discharge denied because debtor paid off car debt instead of student loan); *In re Hayes*, [1978-81 Transfer Binder] BANKR. L. REP. (CCH) ¶ 67,065 (Bankr. W.D. Wisc. Mar. 2, 1979) (paying off debt on second car not undue hardship because "not living within means"); *In re Hayman*, [1978-81 Transfer Binder] BANKR. L. REP. (CCH) ¶ 67,064 (Bankr. S.D. Fla. Apr. 2, 1978) (second car is excessive).

²⁰⁸ Cf. *Senate Hearings on BRA of 1978*, *supra* note 192, pt. I, at 111 (\$120/month for horse-boarding claimed to be excessive).

²⁰⁹ See *id.*; *In re Rice*, 13 Bankr. 614, 617 (Bankr. D.S.D. 1981) (\$30/month long-distance phone bills factor showing that debtor's lifestyle is excessive); *In re Packer*, 9 Bankr. at 887.

²¹⁰ See *In re Rice*, 13 Bankr. at 617.

²¹¹ See *id.*

²¹² See *In re Schongalla*, 4 Bankr. 360, 363 (Bankr. D. Md. 1980) (chapter 13 bankruptcy—\$1440 spent on reading material over three years indicates lack of good faith).

²¹³ See *In re Brown*, 18 Bankr. at 219, 224; *In re Price*, 1 Bankr. 768 (Bankr. D. Hawaii 1980) (expenses for private education of debtor's children were excessive); *In re Kammerud*, 15 Bankr. 1, 10 (Bankr. S.D. Ohio 1980) (court sympathizes with debtor's expenses incurred to get private educational help for son).

²¹⁴ See *In re Brown*, 18 Bankr. at 224; *In re Dempsey*, BK-78-18, (Bankr. W.D.N.Y. Nov. 17, 1980).

²¹⁵ See *In re Breckenridge*, 12 Bankr. 159 (Bankr. S.D. Ohio 1980) (chapter 13 plan not proposed in good faith where debtor paid church tithe); *In re Townsend*, [1978-81 Transfer Binder] BANKR. L. REP. (CCH) ¶ 67,140 (Bankr. E.D. Pa. 1978) (debtor should reduce charitable contributions by amount sufficient to eliminate debt).

²¹⁶ See *In re Packer*, 9 Bankr. at 887 (not permitted where only job-related); *In re Kammerud*, 15 Bankr. at 1.

sist children one is not legally obligated to support,²¹⁷ or a desire to start a family²¹⁸ or a new business?²¹⁹ Are recreation expenses to be regulated?²²⁰ May one spouse discharge the other's debts?²²¹ Is the debtor to be permitted to save any money to pay the future medical expenses of a child with an incurable disease?²²² It has been suggested that proposals to reach the debtor's future income are objectionable because the debtor will not cooperate and will not produce future income.²²³ It is more likely that such proposals are objectionable because they will work too well and completely undermine the fresh-start policy that has been pursued in this country since 1898.

The English system of conditions and suspensions, in some respects, certainly provides an approach to discharge policy generally preferable to the traditional American approach. It is more sensible from a distributional point of view because it contains few exceptions to discharge. We tend to think of exceptions to discharge in a bilateral fashion, as a matter of equity between debtor and creditor. But if the debtor has postpetition resources that are to be applied to creditors' claims, we should also reflect on the legitimacy of preferring one creditor over another. Consider, for example, the case in which the debtor has given a false financial statement in order to purchase a television set on credit. This debt is not discharged by bankruptcy.²²⁴ The debtor also has an unpaid hospital bill for a lifesaving operation. This claim will be discharged.²²⁵ Both claims are treated equally for the purposes of distributing whatever property the debtor owns at the date of the petition.²²⁶ But the exception to discharge gives the seller of the television set a distributional advantage if the debtor has postpetition resources. This result seems wrong on the merits and is inconsistent with the treatment of the debtors' claims while the bankruptcy proceeding is pending. There is less need for such exceptions to discharge in a condi-

²¹⁷ See *In re Rice*, 13 Bankr. at 614.

²¹⁸ See *supra* text accompanying notes 119-22 (Hearing Number Three).

²¹⁹ See *In re Rossotto*, 10 Bankr. at 378 (desire to start a new business increases debtor's chances for future financial success, which in turn is a factor weighing against granting a discharge).

²²⁰ See *In re Brown*, 18 Bankr. at 224; *In re Schongalla*, 4 Bankr. at 363 (\$2,160 spent for recreation over three years is a factor indicating lack of good faith).

²²¹ See *In re Perkins*, 11 Bankr. at 160 (debtor's payment as restitution for husband's bad checks shows lack of undue hardship where husband has enough income to pay for himself).

²²² The answer apparently is "no." See *In re MacPherson*, 19 COLLIER BANKR. CAS. 178 (Bankr. W.D. Wisc. 1978), criticized in 3 COLLIER ON BANKRUPTCY ¶ 523.18 n.6 (L. King 15th ed. 1982).

²²³ See *supra* text accompanying note 183.

²²⁴ 11 U.S.C. § 523(a)(2)(B) (Supp. V 1981).

²²⁵ None of the exceptions found in 11 U.S.C. § 523 applies.

²²⁶ 11 U.S.C. § 721(a)(2) (Supp. V 1981).

tional system.²²⁷

We may also approve of the flexibility of the English approach. Forgiveness is possible. Even the most reprehensible debtor may rehabilitate herself. Although we seem to be moving in the same direction, the American bankruptcy process today does not possess an equivalent capacity for forgiveness.²²⁸ This is a substantial shortcoming, but the flexibility of the English process, the ability to respond to the facts of an individual case, is purchased at a potentially high cost. The discretion enjoyed by the judge in such a system provides an extraordinary opportunity for debtor exploitation. The abstract proposition that there should be no abuse of the discharge process commands support. But the risk of implementing this policy through use of rules of condition and suspension is directly related to the flexibility provided by such rules. Those who oppose greater reliance on rules of condition have noted this concern.²²⁹ Proponents of legislation such as H.R. 4786 and S. 2000, however, usually fail to advert to the problem²³⁰ or minimize the extent to which the bankruptcy judge will be asked to become a manager of the debtor's affairs.²³¹

All this is not to suggest that rules of condition and suspension cannot work in the United States. Given the link between discharge and distribution inherent in English discharge policy, one must admire the skill with which English judges have harmonized the interests of debtors, creditors, and society. Their approach to debtor relief, the product of many years of experience, is a masterly blend of austerity, pragmatism, and compassion. But the fact remains that the collection of

²²⁷ See *supra* text accompanying notes 130-34. S. 2000 does not acknowledge this fact. Indeed, it seeks to increase the exceptions to discharge in Chapter 13. See Senate bill, *supra* note 190, § 19.

²²⁸ A debtor who is denied a discharge pursuant to 11 U.S.C. § 727(a) (Supp. V 1981) may become eligible for a discharge in a subsequent proceeding. Debts that would have been discharged if the debtor had received a discharge in the first proceeding, however, remain nondischargeable even though the debtor subsequently receives a discharge. See *id.* § 523(a)(9). The debtor may obtain relief from these obligations by successfully completing a Chapter 13 plan. *Id.* § 1328(a).

²²⁹ See *Senate Hearings on BRA of 1978*, *supra* note 192, pt. I, at 300 (statement of Richard Levin); *id.*, pt. II, at 71 (statement of Phillip Schuchman), 72-73 (statement of Ellen Broadman), & 145 (statement of Judge Dean Gandy).

²³⁰ The rules which the bankruptcy judge would use to determine the presence of excess income are not described in testimony before Congress. See, *Senate Hearing on BRA of 1978*, *supra* note 192, pt. I, at 6-12 (statement of Andrew F. Brimmer), 39-45 (statement of Jonathon M. Landers), 106-09 (statement of Paul J. Pselsticker), 153-55 (statement of Norman C. Grant), 160-62 (statement of Richard F. Kerr); *id.*, pt. II, at 11-17 (statement of James C. Barr), 17-22 (statement of Robert W. Johnson). Even the Purdue Study, *supra* note 9, does not attempt to pass judgment on many individual expense items in reaching its conclusion that debtors can afford to pay some portion of their nonmortgage debt. Instead, it relies heavily on a general standard of living using the Bureau of Census' definition of poverty.

²³¹ See *Senate Hearings on BRA of 1978*, *supra* note 192, pt. II, at 38 (statement of Claude L. Rice).

debts, not the immediate return of an honest debtor to productive society, is the primary focus of English bankruptcy legislation. There can be no doubt that English debtors as a class are currently subject to more severe treatment than their American counterparts. Indeed, any bankruptcy process which places heavy reliance on rules of condition and suspension must operate in this fashion. And this is precisely the point that supporters of H.R. 4786 and S. 2000 fail to confront. Indeed, if the United States is ready, in large part, to abandon the fresh-start policy first adopted by Congress in 1898, and further, is willing to allocate responsibility for balancing the interests of debtors, creditors, and society to the trial court judges, then these proposed bills are appropriate. It is clear that passage of H.R. 4786, S. 2000, or similar legislation, will signal the beginning of a new era in American discharge policy.

VI. CONCLUSION

Any bankruptcy law must, of necessity, be an accommodation between competing interests that include the creditor's desire to be paid, the debtor's desire to escape a burdensome situation, the value society places on having people pay their debts in full, and the value society places on allowing debtors to start anew when overtaken by financial misfortune. An accommodation can be made at different points on the available spectrum of choices. Congress should be able to strike a new balance between the interests of debtors, creditors, and society as it sees fit to meet changing needs.

But before a new balance is struck, in this case by the denial of the benefits of liquidation bankruptcy to those that some believe can pay their debts, the consequences of such action should be understood. Our knowledge of the English system and some experience with the conditional discharge of educational debts in our country suggests that the bankruptcy judge will be given almost unlimited power to determine the lifestyle of a debtor who seeks a discharge. Whether this change will produce a system which is any less or more desirable than that which we have now depends upon one's values. It is probable that the relative success or failure of a new approach to discharge policy will depend, to a great extent, upon the humanity with which the bankruptcy judges exercise the powerful discretion to be conferred upon them. But on one point there should be agreement. If enacted, the change currently being advocated before Congress will, in its own way, be just as radical a shift in discharge policy as that which occurred when Congress adopted a new bankruptcy statute in 1898.

